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In the Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

JURISDICTIONAL STATEMENT

CHARLES FRIED
Acting Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

ALBERT G. LAUBER, JR.
Assistant to the Solicitor General

ERNEST J. BROWN
Attorney

Department of Justice
Washington, D.C. 20530
(202) 633-2217

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether, in computing the federal estate tax payable by the estate of a decedent who died on November 9, 1978, amendments to the federal tax laws passed by Congress on September 16, 1976, and approved by the President on October 4, 1976, may constitutionally be applied to ascertain the effect upon that computation of gifts made by the decedent on September 28, 1976, and of an election made by him in a federal gift tax return filed on September 30, 1976.

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JURISDICTIONAL STATEMENT

OPINION BELOW

The order of the district court (App., *infra*, 1a-6a) is unreported.

JURISDICTION

The judgment of the district court (App., *infra*, 7a) was entered on January 23, 1985. A notice of appeal (App., *infra*, 8a) was filed on February 21, 1985. On April 16, 1985, Justice Stevens extended the time for docketing the appeal to and including June 21, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1252. A direct appeal lies where, as here, a federal statute has been held unconstitutional as applied. *United States* v. *Darusmont*, 449 U.S. 292, 293 (1981) (per curiam).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant constitutional and statutory provisions are set out in a statutory appendix (App., *infra*, 9a-11a).

STATEMENT

In 1976, Congress significantly changed the relationship between the federal gift tax and the federal estate tax. Previously, a taxpayer was entitled to a $30,000 lifetime gift-tax exemption for inter vivos transfers, and his estate was entitled to a $60,000 estate-tax exemption for transfers at death. Congress in 1976 replaced these two exemptions with a "unified credit." In an effort to produce continuity between the two tax regimes, Congress provided in 1976 that a person (or the estate of a person) who had claimed the $30,000 gift tax exemption for certain gifts could not later claim the full "unified credit" against the gift or estate tax. Rather, the "unified credit" in such circumstances was required to be reduced to reflect the transfer tax benefit that the individual had already garnered. The district court held that this transitional rule was a species of retroactive legislation and that it was so arbitrary and capricious as to render it unconstitutional under the Due Process Clause of the Fifth Amendment.

A. The Statutory Framework

1. Prior to 1977, the estate tax and the gift tax, while functionally related, were separately imposed, separately administered, and separately collected. The gift tax is recurrent (*i.e.*, collected on an annual or quarterly basis) and, to guarantee progressivity, it has always been cumulative. All taxable gifts

made by a taxpayer after June 6, 1932, in other words, are aggregated in order to determine the tax rate or "bracket" applicable to a particular gift.[1] The gift tax provided an annual, per-donee exclusion ($3,000 in 1976, $10,000 now). It also provided a lifetime "specific exemption"—basically a deduction—in the amount of $30,000 (26 U.S.C. (1970 ed.) 2521). A taxpayer could claim the "specific exemption," in whole or in part, whenever he chose. The estate tax, of course, has never been recurrent, but is imposed at fixed rates on the taxable estate at death. In 1976 it provided a $60,000 exemption—again, basically a deduction—in determining the taxable estate (26 U.S.C. (1970 ed.) 2052).

Though separate in most aspects, the gift and estate taxes were never entirely unconnected. From the beginning, it was clear that some property, the lifetime transfer of which was subject to gift tax, might also be included in the transferor's estate for estate tax purposes. Common examples were gifts in contemplation of death (26 U.S.C. (1970 ed.) 2035) and transfers with a retained life interest (26 U.S.C. (1970 ed.) 2036). To alleviate the double tax burden in such situations, Congress provided that, where the transfer of property includable in the gross estate had previously been subject to gift tax, a credit was allowable against the estate tax for the gift tax paid (26 U.S.C. (1970 ed.) 2012).[2]

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[1] See 26 U.S.C. 2502. The cumulation begins with June 6, 1932, the date the gift tax was reimposed. Revenue Act of 1932, ch. 209, Tit. III, 47 Stat. 245 *et seq.*

[2] Because of possible differences in value at the time of the gift and at the time of the decedent's death, differences in the amount of the taxable estate and the aggregate taxable gifts,

2. In the Tax Reform Act of 1976, Pub. L. No. 94-455, Tit. XX, 90 Stat. 1846 *et seq.*, Congress substantially integrated the estate and gift taxes without greatly altering the coverage of either. The first step was to bring the two rate structures—previously, gift tax rates were 75% of estate tax rates on comparable transfers—into conformity.[3] Then, in lieu of the $30,000 "specific exemption" from the gift tax and the $60,000 exemption from the estate tax, Congress provided a credit, termed the "unified credit," available against either or both taxes as first incurred.[4] Finally, a somewhat intricate mechanism for unification was supplied by providing that the estate tax should be determined (subject to the "unified credit") by a computation that first aggregated the taxable estate and taxable gifts made after December 31, 1976; computed a tax on that aggregate sum; and then reduced the result by the gift tax payable on the gifts thus included.[5] Roughly speaking, the result was to treat the taxable estate as the "ultimate taxable gift." See generally J. McCord, *1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary* (1977).

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and different rates and structures, computation of the gift tax credit was, to say the least, complex. See Treas. Reg. § 20.2012-1 (1970).

[3] See Pub. L. No. 94-455, § 2001(b)(1), 90 Stat. 1849 (amending 26 U.S.C. 2502(a)).

[4] See Pub. L. No. 94-455, § 2001(a)(2), (3) and (4), 90 Stat. 1848 (adding 26 U.S.C. 2010, amending 26 U.S.C. 2012 and repealing 26 U.S.C. (1970 ed.) 2052); Pub. L. No. 94-455, § 2001(b)(2) and (3), 90 Stat. 1849 (adding 26 U.S.C. 2505 and repealing 26 U.S.C. (1970 ed.) 2521).

[5] Pub. L. No. 94-455, § 2001(a)(1), 90 Stat. 1846 (amending 26 U.S.C. 2001).

The 1976 Act was effective with respect to estates of decedents dying after December 31, 1976, and with respect to gifts made after that date. But while the Act ushered in a measure of integration between the two tax regimes, it did not purport to provide a completely fresh start, and could hardly have done so. Continuity with the past necessarily had to be provided for. The estate of a decedent dying after 1976, for example, would continue in many cases to include assets that he had disposed of before 1977, such as property transferred in contemplation of death or with a retained life interest. Where such prior transfers had been subject to gift tax, the gift tax previously paid would produce a credit against the post-1976 estate tax. And because the gift tax itself remained cumulative, gifts made before 1977 continued to affect the impact of the (higher) gift tax rates applicable to gifts made during or after that year. See 26 U.S.C. 2501(a), 2502.

Most relevant for present purposes, a nettlesome question of continuity arose from the fact that the $30,000 "specific exemption" from the gift tax, which a taxpayer could employ at the time or times of his choice, was, together with the $60,000 exemption from the estate tax, to be repealed, and the new "unified credit," applicable against either or both taxes, was to be substituted therefor. Obviously, some taxpayers would have employed all or part of the $30,000 specific exemption against pre-1977 gifts. The question was whether this fact should call for an adjustment in the unified credit that they or their estates might subsequently claim.

The bill reported by the House Ways and Means Committee on August 6, 1976, answered this question in the affirmative. It provided that if the specific

exemption had been claimed by a taxpayer in whole or in part at any time after June 6, 1932, the unified credit otherwise allowable was to be reduced by 20% of the amount so claimed. H.R. 14844, 94th Cong., 2d Sess. §§ 2010(c), 2505(c) (1976) (set forth at H.R. Rep. 94-1380, 94th Cong., 2d Sess. 94, 131 (1976)). The Committee explained its proposal as follows (H.R. Rep. 94-1380, at 16):

> As a transitional rule, the unified credit allowable is to be reduced by an amount equal to 20 percent of the amount allowed as a specific exemption in computing taxable gifts under present law. Thus, in the case where a donor had benefited from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit allowable would be reduced by $6,000.

Although the legislative history does not address the matter, the 20% figure was apparently chosen because it was thought to approximate the average effective gift tax rate, and thus to represent the average transfer tax benefit realized by decedents who previously had claimed some or all of the $30,000 specific exemption.

The Conference Committee, in adding provisions of H.R. 14844 to the pending Tax Reform Act of 1976, limited the scope of this transitional rule. It decided that the transitional rule should apply, not in the case of all gifts made after June 6, 1932, but only in the case of gifts made after September 8, 1976—the date the Conference Committee approved the measure. The Committee reports do not explain the reason for thus limiting the scope of the transitional

rule.[6] But the transitional rule, with the limitation added in conference, has uniformly been understood to serve the objective of removing the incentive to make large gifts during the period between September 8, 1976, and January 1, 1977—gifts that otherwise would have provided a double tax benefit in the form of a $30,000 "specific exemption" under the old regime coupled with an undiminished "unified credit" under the new. See *Estate of Gawne* v. *Commissioner*, 80 T.C. 478, 483 (1983); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* ¶ 3.02, at 3-4 n.9 (5th ed. 1983); J. McCord, *supra*, § 2.13, at 26.

The Tax Reform Act of 1976, incorporating the transitional rule described above, was passed by both Houses of Congress on September 16, 1976. It was signed by the President on October 4, 1976. The transitional rule is currently codified in 26 U.S.C. 2010(c) and 2505(c).

B. The Proceedings in this Case

The facts were stipulated, and the case was submitted to the district court on those stipulated facts. On September 28, 1976, Charles Hirschi made gifts aggregating $45,000 in value to five persons (App., *infra*, 2a). Two days later, he reported those gifts on a federal gift tax return, which indicated no tax due (*id.* at 2a-3a). The first $15,000 of his gifts, consisting of $3,000 transfers to each of the five recipients, was exempt from gift tax by virtue of the

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[6] Each report states simply that "the unified credit is not to be reduced for any amount allowed as a specific exemption for gifts made prior to September 9, 1976." H.R. Conf. Rep. 94-1515, 94th Cong., 2d Sess. 607-608 (1976); S. Conf. Rep. 94-1236, 94th Cong., 2d Sess. 607-608 (1976).

annual per-donee exclusion (26 U.S.C. (1970 ed.) 2503(b)). As to the $30,000 balance, Hirschi elected to apply the full amount of his lifetime "specific exemption," thus eliminating any tax (App., *infra*, 1a-2a).

About two years later, on November 9, 1978, Hirschi died (App., *infra*, 2a). Appellee Farmers & Merchants Bank filed a federal estate tax return on behalf of the estate. On that return, the $45,000 in gifts described above were included in the gross estate as gifts in contemplation of death (*ibid.*). The estate claimed a "unified credit" of $34,000, the maximum amount then allowable. See 26 U.S.C. (1976 ed.) 2010(b). On audit, the Commissioner determined that, since Hirschi had claimed a $30,000 specific exemption for gifts made after September 8, 1976, the "unified credit" allowable to his estate had to be reduced by $6,000—20% of the $30,000 specific exemption previously claimed—under the transitional rule of Section 2010(c). The Commissioner accordingly asserted a deficiency in estate taxes in the amount of $6,000 (App., *infra*, 2a).

Appellees paid the asserted deficiency, filed a claim for refund, and eventually brought this refund suit in the United States District Court for the Southern District of Illinois. They contended inter alia that, if Section 2010(c) were applied in the case of gifts made before the enactment of the Tax Reform Act of 1976 on October 4, 1976, it would to that extent be retroactive, and would thus violate the Fifth Amendment by depriving them of property without due process of law.[7]

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[7] Appellees also contended that, as a matter of statutory interpretation, Section 2010(c) should be construed as inapplicable if the property with respect to which the specific

The district court recited that "[t]he first issue raised by the plaintiffs which we will address concerns whether the retroactive provision of [26 U.S.C.] 2010 is unconstitutional and thus violates the due process clause of the Fifth Amendment" (App., *infra*, 3a). The court acknowledged (*id.* at 3a-4a) that this Court has repeatedly upheld retroactive application of income tax legislation, but on the asserted authority of *Shanahan* v. *United States*, 447 F.2d 1082 (10th Cir. 1971), stated that those decisions do not apply to transfers subject to the estate and gift tax laws. Rather, the court reasoned, this case was controlled by *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), where the Court held that the federal gift tax, newly imposed in 1924, could not constitutionally be applied to gifts completed before its enactment. The court found *Milliken* v. *United States*, 283 U.S. 15 (1931), which upheld the application of an amended estate tax statute to a previously-completed gift in contemplation of death, distinguishable. The court held that "the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional" (App., *infra*, 6a). It accordingly entered judgment for the appellees (*id.* at 7a).

THE QUESTION IS SUBSTANTIAL

The district court has squarely invalidated a federal tax statute on grounds of repugnancy to the Con-

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exemption had been claimed was included in the decedent's gross estate. (As noted above, the decedent's September 28, 1976, gifts were included in his gross estate as gifts in contemplation of death.) Appellees' statutory argument had been squarely rejected in *Estate of Renick* v. *United States*, 687 F.2d 371 (Ct. Cl. 1982), and the court below did not consider it.

stitution. Although the statute invalidated is a relatively obscure transitional rule, the decision below has ramifications far beyond the revenue involved in this particular case. The district court's reasoning is broad and would disable Congress from enacting any amendment to the estate or gift tax laws—and perhaps amendments to the income tax laws as well—containing retrospective features of any sort. The decision below thus threatens to affect adversely the administration of the revenue by circumscribing what had heretofore been regarded as the unquestioned prerogative of Congress in enacting tax statutes. The decision below is plainly erroneous, and the principles governing the constitutionality of retroactive legislation, especially tax legislation, are well settled, having been established by a long line of decisions culminating in *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, No. 83-245 (June 18, 1984). For these reasons, the Court may wish to consider summary reversal, the course it followed in *United States* v. *Darusmont*, 449 U.S. 292 (1981) (per curiam).

1. The district court held that the challenged transitional rule violated the Fifth Amendment's prohibition against depriving any person of property without due process of law. But appellees were deprived of no property, with or without due process. The estate tax assessed by the Commissioner, after reducing the allowable unified credit from $34,000 to $28,000 pursuant to Section 2010(c), was $87,690.56 (Stip. ¶¶ 8 & 10; Stip. Exhs. C & D). On the other hand, had the tax laws not been amended in 1976, and had the provisions of the Internal Revenue Code as it existed on September 28, 1976, when the decedent made his gifts, been applied to his estate, the estate tax would have been $88,345.72 (see Stip. Exh.

C; 26 U.S.C. (1970 ed.) 2001, 2052). The Tax Reform Act of 1976, signed by the President on October 4, 1976, thus reduced the estate tax due from the Hirschi estate, and saved appellees $655.16. It can scarcely be said to have deprived them of property.

It is of course true that Congress did not extend to the Hirschi estate the same double tax benefit that it effectively made available to persons (and estates of persons) who claimed the specific exemption for gifts made before September 9, 1976, and who in consequence were not covered by the transitional rule. But Congress's decision not to extend that benefit to people like appellees did not deprive them of property. Such line-drawing is an inherent feature of tax legislation. See *United States* v. *Maryland Savings-Share Insurance Corp.*, 400 U.S. 4 (1970).

2. Contrary to the district court's statement, the application of Section 2010(c) to appellees does not constitute "retroactive" legislation, and the court thus erred in subjecting it to heightened due process scrutiny. The decedent when he made his gifts got the full benefit of the then-existing $30,000 specific exemption for gift tax purposes. The Tax Reform Act of 1976 was signed by the President one week later, and thus became law more than two years before Hirschi died. When he died, his estate got the benefit of the then-existing (albeit reduced) unified credit. It is true that this credit was reduced by reference to gifts Hirschi had made two years earlier. But this Court has regularly held that an estate tax provision which is effective at the date of death "does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States* v. *Jacobs*, 306 U.S. 363, 367 (1939)

(footnote omitted). Accord, *United States* v. *Manufacturers National Bank*, 363 U.S. 194, 200 (1960).[8]

Indeed, the application of the estate tax regularly depends on facts and conditions that may have come into being before the operative estate tax provision was enacted. As noted above, the estate tax has never been limited to property owned by the decedent at the time of his death, but has always, in its original form and as variously amended, included in the decedent's gross estate property transferred or other-

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[8] In *Jacobs*, the decedent had paid for property and had it conveyed to himself and his wife as joint tenants in 1909, seven years before the estate tax was enacted (306 U.S. at 364). He died after the Revenue Act of 1924 required that jointly held property be included in the gross estate of a decedent who had furnished the consideration for the transfer. The Court noted that the challenged estate tax "was not levied on the 1909 transfer," but on the testamentary transfer that occurred after the law was amended in 1924, and accordingly held that the amendment "was not retroactive" (306 U.S. at 366). In *Manufacturers National Bank*, the decedent in 1936 had divested himself of ownership of a life insurance policy at a time when that would have removed the policy or its proceeds from his gross estate (363 U.S. at 196). The decedent, however, had continued to pay the premiums on the policy until he died (*ibid.*). He died in 1954, after the Revenue Act of 1942 made payment of premiums a test for inclusion of life insurance proceeds in the insured's gross estate. The court held that the 1942 amendment, having become effective long before the decedent died, "cannot be said to be retroactive in its impact"; the fact that "the policies were purchased and the policy rights were assigned before the statute was enacted," the Court said, was "not material" (363 U.S. at 200). If neither of these cases involved retroactivity, it is clear that the district court erred in characterizing the application of Section 2010(c) as retroactive here. See also *Fernandez* v. *Wiener*, 326 U.S. 340 (1945); *Gwinn* v. *Commissioner*, 287 U.S. 224 (1932).

wise acted upon by him at some earlier time. This Court has not suggested that the estate tax operates "retroactively" simply because that "earlier time" is a time before enactment of the statutory provision dictating how such property or its transfer shall be treated for estate tax purposes. See, *e.g.*, *United States* v. *Wells*, 283 U.S. 102 (1931); *Gwinn* v. *Commissioner*, 287 U.S. 224 (1932); *United States* v. *Jacobs*, 306 U.S. 363 (1939); *Helvering* v. *Hallock*, 309 U.S. 106 (1940); *Fernandez* v. *Wiener*, 326 U.S. 340 (1945); *Commissioner* v. *Estate of Church*, 335 U.S. 632 (1949); *United States* v. *Manufacturers National Bank*, 363 U.S. 194 (1960).

3. Even if Section 2010(c)'s transitional rule were thought to deprive appellees of property, and to do so "retroactively" by virtue of its look-back feature, its effect is not so harsh or oppressive as to render it unconstitutional under the Due Process Clause. This Court has squarely rejected the idea that retroactivity in an estate tax statute necessarily invalidates it, pointing out that "a tax is not necessarily and certainly arbitrary and therefore invalid because retroactively applied, and taxing acts having retroactive features have been upheld in view of the particular circumstances disclosed and considered by the Court." *Milliken* v. *United States*, 283 U.S. 15, 21 (1931). The Court in *Milliken* upheld the application of (higher) estate tax rates imposed by an amended statute to a previously-completed gift in contemplation of death, and also held that the gift could be valued for estate tax purposes at the date of death rather than at the time the gift was made.

This case involves a transitional rule designed to prevent taxpayers from manipulating the timing of their gifts so as to derive a double tax benefit from

the shift to a "unified credit" estate-and-gift-tax regime. The decedent here, having elected on September 30, 1976, to claim the full $30,000 specific exemption permitted to him for the gifts he had made two days before, had no claim under the then-existing statute to any further exemption, or to its equivalent in the form of some future tax benefit. Under the version of the transitional rule adopted by the House Ways and Means Committee, the decedent would likewise have been entitled to no further exemption, or to its equivalent in the form of an undiminished unified credit, either for his September 28 gifts or for any gifts he had made after June 6, 1932. See page 6, *supra*. He gained no greater entitlement to a double tax benefit by virtue of the Conference Committee's decision to limit the application of the transitional rule to gifts made after September 8, 1976. That decision might be thought to confer a windfall on taxpayers who had the good fortune to make gifts before the Conference Committee acted, but, as noted above, such line-drawing is the function of legislation. The application of the transitional rule to appellees was plainly not "so harsh and oppressive as to be a denial of due process" (*United States* v. *Darusmont*, 449 U.S. at 299).[9]

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[9] The district court erred in invoking *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), to support its holding that Section 2010(c)'s transitional rule is unconstitutional. As has repeatedly been pointed out on the frequent occasions when that decision has been distinguished, *Untermyer* involved the retroactive application of the first gift tax—a wholly new tax enacted in 1924—to gifts irrevocably completed before its effective date. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. at 299; *Milliken* v. *United States*, 283 U.S. at 21; *Reed* v. *United States*, 743 F.2d 481, 486 (7th Cir. 1984), cert. denied, No. 84-866 (June 3, 1985); *Fein* v. *United States*, 730 F.2d

4. Finally, the decedent in this case "had ample advance notice" (*United States* v. *Darusmont*, 449 U.S. at 299) of the proposed change in the tax laws. The House Ways and Means Committee approved its (more restrictive) version of the transitional rule on August 6, 1976. The Conference Committee approved on September 8, 1976, the version that was eventually enacted. The bill passed both houses of Congress on September 16, 1976. All these events occurred before the decedent made his gifts on September 28, 1976, and he thus had constructive notice about what the effect of claiming his $30,000 specific exemption would be. This Court has regularly held that there is no constitutional impediment to making a statute effective (as here) from the date of public notice. *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, slip op. 13-14 ("assuming that advance notice of legislative action with retrospective effects is constitutionally compelled, * * * we believe that employers had ample notice" of the contingent liability imposed by an amended pension statute); *United States* v.

1211, 1213-1214 (8th Cir. 1984), cert. denied, No. 84-182 (Oct. 1, 1984) ("the modern trend of decisions has uniformly been to limit" *Untermyer* to the "narrow situation" there involved); *Estate of Ceppi* v. *Commissioner*, 698 F.2d 17, 21 (1st Cir.), cert. denied, 462 U.S. 1120 (1983) (collecting cases and concluding that, in light of *Milliken*'s distinction of *Untermyer*, "*Untermyer* at best remains good law only for the proposition that a wholly new gift tax cannot be applied retroactively"); Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960); Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935). The *Untermyer* decision has no relevance to this case, which involves an amendment to an existing tax statute, and which, as pointed out above, does not in any event operate retroactively.

Darusmont, 449 U.S. at 299 (same, amended tax statute); *United States* v. *Hudson*, 299 U.S. 498 (1937).

Especially should this be so where, as here, a provision with retrospective effects is adopted to prevent a "rush to the door" by persons seeking to circumvent the purpose of the legislation. See *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, slip op. 10-13.[10] The starting date chosen by the Conference Committee for the transitional rule—September 8, 1976—was not chosen arbitrarily, but was the date the Committee approved the bill in question. It was neither harsh, oppressive, nor arbitrary for Congress to remove the incentive for taxpayers to seek the double tax benefit of a $30,000 gift tax exemption, plus an undiminished unified credit, by making gifts after that date and before the January 1, 1977, effective date of the new law.

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[10] See also *Purvis* v. *United States*, 501 F.2d 311 (9th Cir. 1974), cert. denied, 420 U.S. 947 (1975) (sustaining application of the interest-equalization tax, designed to stem outflow of investment capital from the United States, retroactively to transactions consummated during the previous year); *First National Bank* v. *United States*, 420 F.2d 725 (Ct. Cl.), cert. denied, 398 U.S. 950 (1970) (same).

CONCLUSION

Probable jurisdiction should be noted and the judgment of the district court should be reversed.

Respectfully submitted.

CHARLES FRIED
Acting Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

ALBERT G. LAUBER, JR.
Assistant to the Solicitor General

ERNEST J. BROWN
Attorney

JUNE 1985

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF ILLINOIS

No. 83-5069

ALVIN HEMME, DENNIS HEMME and RON HEMME, and FARMERS AND MERCHANTS BANK OF HIGHLAND, a corporation, as TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI, PLAINTIFFS

vs.

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA, and COMMISSIONER OF INTERNAL REVENUE, DEFENDANTS

[Filed Jan. 23, 1985]

ORDER

This is a civil action for the refund of federal estate taxes which the plaintiffs allege were erroneously assessed and collected. The parties have requested that the court make a ruling based upon the briefs filed and on stipulation of facts submitted. After hearing oral arguments the matter was taken under advisement.

On September 28, 1976, Charles W. Hirschi made gifts to five individuals totalling $45,000.00. In reporting these gifts on September 30, 1976 on his federal gift tax return Mr. Hirschi elected to apply the specific exemption of the then existing IRC Section 2521 in the amount of $30,000.00. This served to exempt $30,000.00 of the gifts from federal gift tax. The remaining $15,000.00 of gifts were also exempted by virtue of the $3000.00 per donee exclusion of Section 2503(b) of the IRC.

On November 9, 1978, Mr. Hirschi died. The decedent's estate filed a timely federal estate tax return. The $45,000.00 worth of gifts made on September 28, 1976, were included on the return as part of decedent's estate by virtue of IRC Section 2035 which required the inclusion in the estate of gifts made in contemplation of death. In calculating the amount of estate tax due, the estate claimed a unified tax credit in the amount of $34,000.00. This was the maximum unified credit then available under Section 2521 of the IRC. In auditing the estate tax return the IRS determined that the $34,000.00 unified credit claimed by the estate must be reduced by $6000.00 because the decedent had previously used his $30,000.00 gift tax specific exemption in connection with his September 28, 1976 gifts. Accordingly, an assessment with respect to the disallowed amount was made against the estate and paid by the estate. The estate then filed a claim with the IRS for a refund which was denied. This suit was subsequently filed.

The Tax Reform Act of 1976 (Act), enacted October 4, 1976, adopted a single state [*sic*] and gift tax rate schedule. Under prior law a donor was entitled to a specific exemption in the amount of $30,000.00 for gift tax purposes and the estate of decedent was en-

titled to a $60,000.00 specific exemption for estate tax purposes. The Act replaced the specific exemptions with respect to gifts made after December 31, 1976 and with respect to the estate of persons dying in 1977 and thereafter with a unified credit. The statute provided that the unified credit be phased in over a five year transaction [*sic*] period, beginning at $30,000.00 for the year 1977 and up to $47,000.00 for 1981 and the years thereafter. As part of the transition, Congress provided for an interim period between September 8, 1976, and January, 1977 whereby the unified credit allowed the estate would be reduced by 20% on all gifts made during the interim period where the $30,000.00 specific exemption was used for gift tax purposes.

Because the decedent made his gift on September 28, 1976, which date fell within the interim period, the credit allowed Mr. Hirschi's estate was reduced by 20%. The first issue raised by the plaintiffs which we will address concerns whether the retroactive provision of 29 [*sic*] USC Section 2010 is unconstitutional and thus violates the due process clause of the Fifth Amendment.

The United States Supreme Court has held that Congress may provide for the retroactive operation of income tax legislation. *Welch v. Henry*, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87 (1938); *United States v. Hudson*, 299 U.S. 498, 57 S.Ct. 309, 81 L.Ed. 370 (1937); *Lynch v. Hornby*, 247 U.S. 339, 38 S.Ct. 543, 62 L.Ed. 1149 (1918). However, the justification for upholding retroactive income taxation does not apply to estate and gift tax because it cannot be assumed that the taxpayer would dispose of his property in the same manner had he known the tax consequences of his act. *Shanahan v. U.S.*, 447 F.2d 1082 (10th Cir. 1971).

The case of *Untermeyer v. Anderson*, 276 U.S. 440, 48 S.Ct. 353, 72 L.Ed. 645 (1928) is similar to the case before us. The Revenue Act of 1924 imposed a tax on all gifts made during the calendar year of 1924 although it did not go into effect until June 2, 1924. In *Untermeyer*, the constitutionality of the tax as applied to a gift made on May 23, 1924, just 12 days before the Act was approved by the President was at issue. Prior to its decision in *Untermeyer*, the court had held the tax unconstitutional as applied to a gift made in January 1924 on the ground that it was so arbitrary as to be a denial of due process. *Blodgett v. Holden*, 275 U.S. 142, 48 S.Ct. 105, 72 L.Ed. 206 (1927). In that case the court stated that "it seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing." 48 S.Ct. at 106. In *Untermeyer*, the government argued that as retroactively applied to this gift the tax was not unconstitutional because the taxpayer had ample notice of the proposed tax and in all likelihood, had made the gift at that particular time to avoid tax liability. The court rejected the argument holding the retroactive application of the tax unconstitutional. The court stated:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation

> and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken.
> 48 S.Ct. at 354.

There have been cases however where a retrospective tax on an estate and gifts has been upheld. *Milliken v. The United States*, 283 U.S. 15, 51 S.Ct. 324, 75 L.Ed. 809 (1931); *Estate of Renick v. United States*, 687 F.2d 371 (Court of Claims 1982). We feel these cases are distinguishable from the case at bar.

In *Milliken* the court held the Revenue Act of 1918 applicable to a gift made in 1916 for estate tax purposes. This holding was based on the similarity of the two statutes. The court found the only difference between the statutes was one of tax rate. The court further noted that the decedent could have anticipated the tax.

The defendant relies on the *Renick* decision for the proposition that the retrospective nature of the Tax Reform Act of 1976 is not so arbitrary and capricious as to render the statute unconstitutional. In *Renick*, the decedent made a gift of $100,000.00 on December 30, 1976, two months after the enactment of the statute here in question. Because the gift was made 2 months after the statute's enactment, the court held that the decedent was afforded a choice in determining how to handle the transaction. The court

stated that "the decedent was afforded a reasonable means or choice to avoid the application of Section 2010(c) to his gift." *Renick* at 377.

In the present case Mr. Hirschi had no such choice. His gift was made and his gift tax returns filed before the statute's enactment. Although the decedent taxpayer, like the taxpayer in *Untermeyer*, may have had notice of the proposed tax he should not be required to guess on what the leglislative outcome would be.

Accordingly, we hold that the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional.

IT IS SO ORDERED.

DATED: This 23rd day of January, 1985.

/s/ William L. Beatty
WILLIAM L. BEATTY
United States District Judge

Note: Clerk to Forward Copies to All Parties.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

Docket Number 83-5069

ALVIN HEMME, ET AL.

v.

UNITED STATES OF AMERICA, ET AL.

[Filed Jan. 23, 1985]

JUDGMENT IN A CIVIL CASE

☐ Jury Verdict. This action came before the Court and a jury with the judicial officer named above presiding. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court with the judge (magistrate) named above presiding. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that judgment is entered in favor of plaintiffs and against defendants.

/s/ A. Marvin Helart
A. MARVIN HELART
Deputy Clerk

/s/ M. Ruth Brooks
M. RUTH BROOKS

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

Civil Action No. 83-5069

ALVIN HEMME, DENNIS HEMME and RON HEMME, and FARMERS AND MERCHANTS BANK OF HIGHLAND, a corporation, as TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA, and COMMISSIONER OF INTERNAL REVENUE, DEFENDANTS

[Filed Feb. 21, 1985]

NOTICE OF APPEAL

NOTICE is hereby given that, pursuant to 28 U.S.C., Section 1252, the defendants hereby appeal to the Supreme Court of the United States from the order and judgment entered herein on January 23, 1985, a copy of which is annexed hereto.

FREDERICK J. HESS
United States Attorney

By: /s/ Robert Simpkins
ROBERT SIMPKINS
Assistant United States Attorney

/s/ Terri E. Schapiro
TERRI E. SCHAPIRO
Trial Attorney, Tax Division
Department of Justice
Washington, D.C. 20530
Telephone: (202) 724-6403

APPENDIX D

The Due Process Clause of the Fifth Amendment to the United States Constitution provides:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *

Internal Revenue Code of 1954 (26 U.S.C. (1970 ed.)):

> Section 2010 [as added by Section 2001(a)(2) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1848]. UNIFIED CREDIT AGAINST ESTATE TAX.
>
> (a) *General Rule.*—A credit of $47,000 shall be allowed to the estate of every decedent against the tax imposed by section 2001.
>
> (b) *Phase-in of $47,000 credit.*—Subsection (a) shall be applied by substituting for "$47,000" the following amount:
>
> In the case of decedents dying in:
>
> | | |
> |---|---|
> | 1977 | $30,000 |
> | 1978 | 34,000 |
> | 1979 | 38,000 |
> | 1980 | 42,500 |
>
> (c) *Adjustment to Credit for Certain Gifts Made Before 1977.*—The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

(d) *Limitation Based on Amount of Tax.*—The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.

* * * * *

Section 2505 [as added by Section 2001(b)(2) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1849]. UNIFIED CREDIT AGAINST GIFT TAX.

(a) *General Rule.*—In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar quarter an amount equal to—

(1) $47,000, reduced by

(2) the sum of the amounts allowable as a credit to the individual under this section for all preceding calendar quarters.

(b) *Phase-in of $47,000 credit.*—Subsection (a)(1) shall be applied by substituting for $47,000" the following amount:

In the case of gifts made:

After December 31, 1976, and before July 1, 1977	$ 6,000
After June 30, 1977, and before January 1, 1978	$30,000
After December 31, 1977, and before January 1, 1979	$34,000
After December 31, 1978, and before January 1, 1980	$38,000
After December 31, 1979, and before January 1, 1981	$42,500

(c) *Adjustment to Credit for Certain Gifts Made Before 1977.* The amount allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the individual after September 8, 1976.

(d) *Limitation Based on Amount of Tax.*— The amount of the credit allowed under subsection (a) for any calendar quarter shall not exceed the amount of the tax imposed by section 2501 for such calendar quarter.

Section 2521 [prior to repeal by Section 2001 (b) (3) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1849]. SPECIFIC EXEMPTION.

In computing taxable gifts for a calendar quarter, there shall be allowed as a deduction in the case of a citizen or resident an exemption of $30,000, less the aggregate of the amounts claimed and allowed as a specific exemption in the computation of gift taxes for the calendar year 1932 and all calendar years and calendar quarters intervening between that calendar year and the calendar quarter for which the tax is being computed under the laws applicable to such years or calendar quarters.

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No. 84-1944

In The
Supreme Court of the United States
October Term, 1984

UNITED STATES OF AMERICA, ET AL.,
Appellants,

v.

ALVIN HEMME, ET AL.,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

MOTION TO DISMISS ON BEHALF OF ALVIN HEMME, ET AL., OR, IN THE ALTERNATIVE, MOTION TO AFFIRM

DONALD C. RIKLI
Attorney for Appellees
914 Broadway
Highland, Illinois 62249
(618) 654-2364

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

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RESTATEMENT OF QUESTION PRESENTED FOR REVIEW

Appellees respectfully disagree with the appellant's statement of the question presented for review. The question presented below is a more factually accurate statement which will emerge from examination of the record below.

Where a decedent made gifts on September 28, 1976 and elected to apply the $30,000 specific exemption against the same, can a reduction of $6,000 in the unified credit pursuant to Internal Revenue Code Section 2010(c) which was amended on October 4, 1976 (when the President signed it into law), constitutionally be made when the same gifts were included in the decedent's gross estate as transfers made in contemplation of death pursuant to Section 2035, as amended?

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No. 84-1944

In The

Supreme Court of the United States

October Term, 1984

UNITED STATES OF AMERICA, ET AL.,

Appellants,[1]

v.

ALVIN HEMME, ET AL.,

Appellees.[2]

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

MOTION TO DISMISS ON BEHALF OF ALVIN HEMME, ET AL., OR, IN THE ALTERNATIVE, MOTION TO AFFIRM

[1]Appellants are: United States of America, Department of the Treasury of The United States of America and Commissioner of Internal Revenue.

[2]Appellees are Alvin Hemme, Dennis Hemme, Ron Hemme and Farmers and Merchants Bank of Highland, a corporation, as Trustee of the Revocable Living Trust of Charles W. Hirschi.

STATEMENT AS TO THE RESTATED ISSUE RAISED BY APPELLANT

The appellees have chosen to restate the issue raised by the appellant in conformity with Rule 15.1(a) of this Court. (Motion to Dismiss on Behalf of Alvin Hemme, et al., or, in the Alternative, Motion to Affirm p. i).

The appellant has made three misstatements of significant facts in his Jurisdictional Statement which must be called to the attention of the Court.

The appellant has misstated the holding of the district court (Appellant's Jurisdictional Statement, p. 2) in the following language:

> "The district court held that this transitional rule was a species of retroactive legislation and that it was so arbitrary and capricious as to render it unconstitutional under the Due Process Clause of the Fifth Amendment."

In reality, the district court held (Appellant's Jurisdictional Statement, Appendix A, p. 6a):

> "Accordingly, we hold the tax under Section 2010(c) *as applied to this transaction* is so arbitrary and capricious as to render it unconstitutional." (Emphasis added.)

The district court did not hold the transitional rule unconstitutional in all events but only as it applied to *this transaction*. The district court narrowly limited its holding to the facts on this case only.

Two additional misstatements by the appellant appear in footnote 7 on page 9 of its Jurisdictional Statement:

> "Appellees' statutory argument had been squarely rejected in *Estate of Renick v. United States*, 687 F. 2d

371 (Ct. Cl. 1982), and the *court below did not consider it.*" (Emphasis added.)

The *Renick* plaintiff's statutory interpretation argument in *Estate of Renick* and the appellees' statutory interpretation argument herein are substantially different. The arguments which the Renick Estate presented and which the *Renick* court rejected were avoided by the appellees in the instant case. Appellees raised new and additional statutory interpretation arguments herein which the *Renick* court did not have before it, and could not, therefore, pass upon and certainly has not rejected as the appellant has tried to lead us to believe.

Furthermore, the district court specifically referred to the *Renick* case four times and quoted from it once. (Appellants' Jurisdictional Statement, Appendix A, pp. 5a-6a). The district court decided the case on the constitutional issue, however, and had no need to decide the issue of statutory construction. The issue of statutory interpretation was raised and was thoroughly briefed and argued before the district court. The district court had the issue before it. In light of these overwhelming facts, it is an utter falsehood for the appellant to say that "the court below did not consider" the appellees' statutory interpretation argument.

NUMEROUS FACTORS MUST BE CONSIDERED IN DETERMINING WHETHER THE QUESTION IS SUBSTANTIAL

The greatest possible extension of this case is only to those persons—

(1) who made gifts between September 9, 1976 and October 3, 1976, both dates inclusive, (a period of 24 days)

(2) who filed their gift tax returns before October 4, 1970 and

(3) elected thereon to use a part or all of their $30,000 specific exemption under Section 2521 against such gifts,

(4) then had the misfortune to die within three years of the date those gifts were made, and

(5) who left estates which were taxable and

(6) had those gifts (or transfers) included in their estates as transfers in contemplation of death.

All of those persons

(7) would have died by October 3, 1979, and

(8) the last of the federal estate tax returns on their estates would have been due on July 3, 1980,

(9) with the Statute of Limitations (Section 6501) on those returns expiring on July 4, 1983, which was over two years ago.

No other reported case contains these facts. Only one other case (involving a gift made on December 31, 1976) *Estate of Renick v. United States,* 687 F. 2d 371 has been reported, but its facts are distinguishable from the instant case. Although the attorney for the appellees has one other case now pending in the United States District Court for the Southern District of Illinois with facts more analogous to those in *Renick* than to those in the case at bar (gift made on October 20, 1976, gift tax return filed in December 31, 1976), it likewise is distinguishable from the instant case. At this late date it is highly unlikely that

any other cases are still pending with facts analogous to those of the case at bar.

The total amount of estate tax involved in this case is $6,000.

The appellant admits that "the statute involved is a relatively obscure transitional rule." (Appellant's Jurisdictional Statement, p. 10). Furthermore, the reasoning of the district court is very restricted. In fact, it is limited to the facts of this case only. It would not disable Congress from enacting amendments to income tax laws containing retroactive features, as the appellant says, for the district court specifically noted that this court has held that Congress may provide for the retroactive operation of income tax legislation (Appellant's Jurisdictional Statement, Appendix A, p. 3a). Likewise the reasoning of the district court would not disable Congress from enacting amendments to estate and gift tax laws containing retroactive features, as the appellant asserts, for the district court recognized that "(t)here have been cases where a retroactive tax on an estate and gifts has been upheld." (citing cases.) (Appellant's Jurisdictional Statement, Appendix A, p. 5a). The district court then distinguished the *Milliken v. United States*, 283 U.S. 15, and *Estate of Renick v. United States*, 687 F. 2d 371, from the instant case.

The appellant is "crying wolf" when he says "The decision below thus threatens to affect adversely the administration of the revenue by circumscribing what had heretofore been regarded as the unquestioned prerogative of Congress in enacting tax statutes." (Appellant's Jurisdictional Statement, p. 10) The judgment of the district court states quite the contrary.

1. The district court properly held that the transitional rule of Section 2010(c) was so arbitrary and capricious as to violate the prohibition against depriving any person of property without due process of law contained in the Due Process Clause of the Fifth Amendment.

The appellant cleverly argues that by reason of the enactment of the Tax Reform Act of 1976 the decedent's estate would have saved $655.16, and, therefore, the decedent's estate had not been deprived of property. (Appellant's Jurisdictional Statement, pp. 10-11). The Tax Reform Act indeed reduced the decedent's estate tax by $655.16, but the appellant ignores the fact that the effect of the Tax Reform Act was to tax the same property of the decedent two times or to double the estate tax on that property (or transfer). The decedent died on November 9, 1978. His death occurred within three years of the date on which he made the above gifts. An estate tax return was timely filed and the gifts made on September 28, 1976 were reported and included as transfers made in contemplation of death under Section 2035. In addition, pursuant to Section 2010(c), which was signed into law on October 4, 1976, an adjustment of $6,000 (20% of the $30,000 specific exemption) was made reducing the amount of the unified credit alowable on the decedent's estate tax return. As a result of this adjustment, the decedent's estate received only a $28,000 unified credit ($34,000 minus $6,000) rather than the full $34,000 unified credit applicable to estates of decedents dying duing 1978. The effect of the Appellant's interpretation of these two sections of the Internal Revenue Code is to tax the same property (or transfer) twice or to double the estate tax on that property (or transfer). The appellant tries to cover up the fact of

double taxation in this case by arguing that congress did not extend to the Hirschi estate the "double tax benefit" which it gave to other persons who claimed the specific exemption on gifts made before September 9, 1976. (Appellant's Jurisdictional Statement, p. 11). No doubt what the appellant refers to is 1) the estate tax reduction of $655.16 resulting from the changes in the Tax Reform Act of 1976 over the prior law and 2) the granting to pre-September 9, 1976 donors (and to post-September 9, 1976 donors who did not elect to use any part of their specific exemption) an additional $6,000 unified credit on death, but the appellant does not explain. As a matter of fact, Congress did not give a "double tax benefit" to all such persons, because they were still subject to the "transfers in contemplation of death" rule of Section 2035. Section 2010(c) enacted on October 4, 1976 effectively deprived the appellees of property by taxing that property twice, once under Section 2010(c) and again under Section 2035, resulting in double taxation of the same property. It is interesting to note that if the decedent had died before January 1, 1977 (the effective date of the Tax Reform Act of 1976) his estate tax would have been $6,000 less than the appellant claims, because pre-1977 law then would have applied to his estate. His estate also would not have been entitled to the $655.16 estate tax reduction resulting from the changes in the Tax Reform Act of 1976 over the law then in effect.

Appellant cites *United States v. Maryland Savings-Share Insurance Corp.*, 400 U.S. 4 (1970) an income tax case in support of its argument. Appellees do not disagree with the holding of that case as it applies to amendments to income tax laws, but, as stated above, here we are dealing with amendments to estate tax laws.

2. The application of Section 2010(c) to the appellees constitutes retroactive legislation, and the district court was correct in examining it in light of the Due Process Clause. The decedent made his gifts on September 28, 1976. Two days later (September 30, 1976) he timely filed his gift tax return reporting those gifts and electing to use the $30,000 specific exemption against them. In 1976, Section 6075(a) required the filing of decedent's federal gift tax return on or before the 15th day of the second month following the end of the calendar quarter in which the gifts were made. Since decedent's gifts were made during the July-September quarter, his gift tax return was due on or before November 15, 1976.

The district court held (Appellee's Jurisdictional Statement, Appendix A, p. 6a):

> "In the present case Mr. Hirschi had no such choice. His gift was made and his gift tax returns filed before the statute's enactment. Although the decedent taxpayer, like the taxpayer in *Untermyer*[3], may have had notice of the proposed tax he should not be required to guess on what the legislative outcome would be."

There was a possibility that the President would not sign the Tax Reform Act of 1976 into law. Although this was unlikely, this uncertainty prevailed throughout the period that the decedent made the gifts and filed his gift tax returns. The President signed the Tax Reform Act of 1976 into law six days after the decedent made the gifts and four days after he filed his gift tax returns.

---

[3]*Untermyer v. Anderson*, 276 U.S. 440 (1928).

The appellant has cited *United States v. Jacobs*, 306 U.S. 363, 367 (1939) and *United States v. Manufacturers National Bank*, 363 U.S. 194, 200 (1960).

The *Jacobs* and *Manufacturers National Bank* cases are quite unlike the instant case. In *Jacobs*, the property in question was acquired by the decedent in 1909, and the estate tax was enacted seven years later (1916). The decedent died on June 17, 1924, thus giving the decedent ample time (8 years after the estate tax became law, but only 15 days after the estate tax was amended) to structure his estate so as to minimize estate taxes regarding the property in question. Nevertheless, *Jacobs* had an opportunity to change his situation. Such was not the case here. In the instant case, the decedent made the gifts. Two days later he filed his gift tax return. Four days after that the president signed the Tax Reform Act of 1976 into law. The *Jacobs* case is distinguishable from the case at bar and is not applicable here.

In *Manufacturers National Bank* the decedent divested himself of ownership of a life insurance policy in 1936, but he continued to pay the premiums thereon. In 1942 the Revenue Act of 1942 made the payment of premiums a test for including the policy proceeds in his estate. The deceased died in 1954, which was 12 years after the 1942 Revenue Act was passed, thus giving him 12 years in which to stop paying premiums on the policy. Charles Hirschi did not have 8 years or even 15 days (as in *Jacobs*) or 12 years (as in *Manufacturers National Bank*) in which to change his situation. Charles Hirschi was locked into his situation and could not extricate himself therefrom. The *Manufacturers National Bank* case is in no way analogous

to the case at bar on the issue of the constitutionality of a retroactive amendment and is not applicable here.

The appellant's argument that "the estate tax has never been limited to property owned by the decedent at the time of his death, but has always, in its original form and as variously amended, included in the decedent's gross estate property transferred or otherwise acted upon by him at some earlier time" (Appellant's Jurisdictional Statement, pp. 12-13), is really immaterial here. What the appellees object to here is the fact that the decedent in this case had made a gift of his property in reliance on the law which was in effect on September 28 and 30, 1976, and then the law was changed on October 4, 1976 and completely altered the tax effect on such gifts. Again, the decedent was locked into his situation, and he could not free himself from it. This is what the district court described as "arbitrary and capricious". (Appellant's Jurisdictional Statement, Appendix A, p. 6a.) Because Section 2010(c) is "arbitrary and capricious" as applied to the facts of this case, it violates the Due Process Clause of the Fifth Amendment.

3. The appellant cites *Milliken v. United States*, 283 U.S. 15, 21 (1931) as rejecting the proposition that retroactivity in an estate tax statute necessarily invalidates it. (Appellant's Jurisdictional Statement, p. 13).

The district court examined the *Milliken* case and said (Appellant's Jurisdictional Statement, Appendix A, p. 5a):

> "There have been cases however where a retrospective tax on an estate and gifts has been upheld . . . (citing *Milliken* and *Renick*) . . . We feel these cases are distinguishable from the case at bar.

> "In *Milliken* the court held the Revenue Act of 1918 applicable to a gift made in 1918 for estate tax purposes. This holding was based on a similarity of the two statutes. The court found the only difference between the statutes was one of tax rate. The court further noted that the decedent could have anticipated the tax."

The *Milliken* court distinguished cases like *Untermyer v. Anderson*, 276 U.S. 440 (1928) and *Nicholas v. Coolidge*, 247 U.S. 531 (1927), where "the nature and amount of the tax burden imposed could not have been understood and foreseen by the taxpayer at the time of the particular voluntary act which made the occasion of the tax." *Milliken* at p. 21.

In the instant case, it was not foreseeable that the decedent's estate would suffer a reduction of $6,000 in the unified credit (the unified credit did not exist on September 28, 1976 or on September 30, 1976) nor would have to pay an additional $6,000 estate tax on the same gifts if he died within three years of making his gift. There was no similar provision for 1) a unified credit or 2) a reduction in unified credit in the Internal Revenue Code prior to the enactment of Section 2010(c) on October 4, 1976. Furthermore, a unified estate and gift taxing system did not exist before October 4, 1976.

This lack of notice, which violates due process and taxes a transfer which was formerly exempt, also distinguishes those cases [like *Brushaber v. Union Pacific, R. R. Co.*, 240 U.S. 1, 20 (1916)] upholding retroactive income taxes. Income tax laws, while frequently changing, are certainly foreseeable. As mentioned above, Section 2010(c) is not only new. It is unique and different. It

creates a unified credit, which previously did not exist. It requires a reduction in the unified credit allowed under the statute as a result of a gift. Then Section 2035(a) requires the inclusion of the same property which constituted the transfer (gift) without making any adjustment therefor. It is a burden which could not have been understood or foreseen at the time of the transfer. It is a transfer which might not have been made, or a transfer for which the decedent might not have claimed a specific exemption, if these burdens could have been understood or foreseen at the time the gifts were made and the gift tax returns were filed.

The appellant characterizes Section 2010(c) as a "transitional rule designed to prevent taxpayers from manipulating the timing of their gifts so as to derive a double tax benefit from the shift to a 'unified' credit estate-and-gift-tax regime." (Appellant's Jurisdictional Statement, p. 14). It is obvious that the appellant recognizes that the Tax Reform Act of 1976 created a new and different "'unified' credit estate-and-gift-tax regime," which had not previously existed in the tax law. But where is the "double tax benefit" to which the appellant refers? Is it (1) the $30,000 specific exemption under Section 2010(c) (which really results in a gift tax savings of $2,250) and (2) the reduction in estate taxes of $655.16, the latter of which is asserted on page 11 of the Appellant's Jurisdictional Statement? Perhaps it is, but on the other hand, the appellant completely ignores the penalty of double taxation to which the decedent's estate is subjected by reason of 1) the $6,000 reduction in the unified credit under Section 2010(c) and 2) the inclusion of the decedent's same $30,000 gifts in his estate under Section 2035.

In the case at bar this resulted in an estate tax of $12,000 rather than $6,000. The decedent certainly could not have anticipated all of these consequences when he made his gifts and filed his gift tax return in September 1976.

The appellant lists the dates of the meetings of the House Ways and Means Committee and the Conference Committee, and while these are all significant, it should be noted that the Tax Reform Act of 1976, did not become law until October 4, 1976 when the President signed it and after the decedent had made his gifts and had filed his gift tax return.

The Appellant cites the *Darusmont* case in support of the application of the transitional rule to the appellees. Again it should be noted that *Darusmont* dealt with a retroactive amendment to the income tax law and not to the estate tax law.

4. In his final point the appellant argues ". . . the decedent in this case 'had ample advance notice' . . . of the proposed change in the tax laws," citing *United States v. Darusmont,* 449 U.S. 292 at 299, the House Ways and Means Committee action on August 6, 1976, the Conference Committee action on September 8, 1976, and the passage of the bill by Congress on September 16, 1976—all occurring before the decedent made his gifts on Septmber 28, 1976. But the appellant cites as his principal authority, *Darusmont* which involved an amendment to the income tax laws. The appellant ignores the fact that the bill was not signed by the President until October 4, 1976, an act constitutionally required before the bill became law. U.S. Constitution, Article I, Section 7. Let us assume for the purposes of argument only that the decedent had notice of

the changes in the tax laws in question. He had made his gifts. What was he to do? His quarterly gift tax return had to be filed on or before November 15, 1976. It had to be filed under the laws then in effect. But it would have ramifications beyond the then-existent tax laws and into the new tax law. These are determinations which he had to make immediately. He did not have the legal treatises upon which the appellant relies, for even J. McCord, 1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary (Appellants Jurisdictional Statement, p. 4, 7) was not published until the following year (in 1977).

The appellant justifies the retroactivity of Section 2010(c) to September 8, 1976, in order "to prevent a 'rush to the door'". (Appellant's Jurisdictional Statement, p. 16) He recognizes, as Congress apparently recognized, that individuals might make gifts in anticipation of the signing of the new tax bill. What both the appellant and Congress failed to recognize is that individuals are making gifts all of the time—some motivated by tax laws, some not so motivated and some motivated by a combination of motives, both tax and non-tax. What both of them also failed to recognize is that in 1976 gift tax returns had to be filed quarterly and that such tax returns had to be filed at the end of the then current quarter under the tax law which was then in effect. Section 6075(a). What both of them also failed to recognize is that in those July-September, 1976 quarterly gift tax returns filed before the new tax bill was signed, taxpayers, such as the decedent, would be making elections—under the old law and not the new law—because the new law was not then in effect. This is what the decedent in this case did. After the decedent had filed his quarterly gift tax return he was locked into his posi-

tion both under the old law, and, when the new law become effective, also under the new law. Under these very limited circumstances, it was harsh, oppressive, arbitrary and capricious for Congress to make Section 2010(c) retroactive to September 8, 1976.

CONCLUSION

Appellees respectfully request the Court to dismiss the Appeal, or, in the alternative, affirm the judgment of the district court.

Respectfully submitted,

DONALD C. RIKLI
Attorney for Appellees

September, 1985

Supreme Court, U.S.
FILED
OCT 2 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1944

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

REPLY MEMORANDUM FOR THE UNITED STATES

CHARLES FRIED
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

BEST AVAILABLE COPY

In the Supreme Court of the United States

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REPLY MEMORANDUM FOR THE UNITED STATES

---

1. In our jurisdictional statement, we pointed out that the challenged transitional rule did not deprive appellees of property within the meaning of the Fifth Amendment, since the overall effect of the 1976 Tax Reform Act was to reduce appellees' estate tax bill by $655.16 (J.S. 10-11). Appellees concede that "[t]he Tax Reform Act indeed reduced the decedent's estate tax by $655.16" (Mot. to Dis. 6). They nevertheless assert, somewhat confusingly, that the transitional rule is unconstitutional because the effect of the 1976 Act was "to tax the same property (or transfer) twice" (*id.* at 6, 7).

There is no factual basis for this assertion. The single tax that was assessed and paid with respect to the property transferred by the decedent on September 28, 1976, was the estate tax paid after the decedent's death in 1978. No tax was paid with respect to that property in 1976 because the decedent elected to apply the gift tax specific exemption of $30,000. That exemption, coupled with the applicable

annual exclusions, meant that no gift tax was paid or payable with respect to the $45,000 transferred. Appellees' assertion that the same property or transfer was taxed twice is thus squarely contrary to fact.

Indeed, it was because the decedent elected to employ the $30,000 specific exemption in 1976 that the transitional rule required that the unified credit be reduced by a roughly equivalent amount when the estate tax was computed in 1978. It is true that if the decedent had *not* elected to apply the specific exemption in 1976, and if he had instead *paid* a gift tax on $30,000 of the property then transferred, his estate would have enjoyed a credit for the gift tax paid, pursuant to Section 2012, plus an undiminished unified credit pursuant to Section 2010. But failure, through one's own election, to obtain two credits is quite different from being taxed twice, or at double rates.

2. Appellees assert that "[w]hat [they] object to here" is the fact that the decedent, having made gifts on September 28, and having filed a gift tax return on September 30, "was locked into his situation, and * * * could not free himself from it," when the President, on October 4, signed the bill that Congress had sent him three weeks earlier (Mot. to Dis. 10). As appellees acknowledge (*id.* at 8), however, the gift tax return which the decedent filed on September 30 was not due until November 15, over a month after the President signed the law. It may well be that the decedent could have filed an amended gift tax return, disclaimed the $30,000 specific exemption, and paid gift tax on $30,000 of the property he transferred on September 28, thereby avoiding the transitional rule his estate now finds offensive. In any event, it was decedent's rather unusual haste in filing his gift tax return two days after he made his gifts that snapped the lock. The lock, moreover, did not greatly constrain or painfully chafe, since it allowed decedent's estate to pay

$655.16 less in estate taxes than would have been exacted under the law applicable to decedent in his "unlocked" condition earlier that year.

Respectfully submitted.

CHARLES FRIED
Acting Solicitor General

OCTOBER 1985

Supreme Court, U.S.
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JOINT APPENDIX

DONALD C. RIKLI, ESQUIRE
914 Broadway
Highland, Illinois 62249
(618) 654-2364
Counsel for Appellees

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217
Counsel for Appellants

JURISDICTIONAL STATEMENT FILED
JUNE 21, 1985
PROBABLE JURISDICTION NOTED OCTOBER 7, 1985

BEST AVAILABLE COPY

Supreme Court, U.S.
FILED
NOV 27 1985
JOSEPH F. SPANIOL, JR.

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DONALD C. RIKLI, ESQUIRE
914 Broadway
Highland, Illinois 62249
(618) 654-2364
Counsel for Appellees

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217
Counsel for Appellants

JURISDICTIONAL STATEMENT FILED
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* The order and judgment of the district court, together with the notice of appeal, are printed in the appendix to the jurisdictional statement and have not been reproduced here.

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF ILLINOIS

No. 83-5069

ALVIN HEMME, DENNIS HEMME AND RON HEMME, AND FARMERS AND MERCHANTS BANK OF HIGHLAND, A CORPORATION, AS TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA, AND COMMISSIONER OF INTERNAL REVENUE, DEFENDANTS

RELEVANT DOCKET ENTRIES

March 9, 1983—1—COMPLAINT submitted
SUMMONS issued and returned to attorney for plaintiff (6)
CONSENT to trial by Magistrate forms mailed x820—EOD, 3/9 pf

March 14, 1983—TPS mailed to attorneys of record, JURY, JANUARY, 1984 book & mmn x820 pf

May 6, 1983—2—RETURN of service, served William F. Smith by certified mail #P266 104 085 signed 3-14-83

May 6, 1983—Proof of service (pltfs)—called atty for proper acknowledgments, not ret. rec.

May 10, 1983—3—ANSWER and defenses (defts) X820
TPS and Mag forms mailed to trial atty, Heald

October 3, 1983—4—MOTION for leave to add party pltf and to file first amended complt Proposed first amended complaint & proposed order

October 6, 1983—5—ORDER (WLB) granting leave to add party pltf and file first amended complaint cc

October 6, 1983 – FIRST AMENDED COMPLAINT adding Farmers and Merchants Bank of Highland

December 8, 1983 – Notices mailed for nonjury trial set for the month of January.

January 27, 1984 – NOTICES mailed for non-jury trial set for the month of March.

February 24, 1984 – 7 – STIPULATION OF FACTS

February 24, 1984 – 8 – ORDER (WLB) Stipulation of Facts filed. Pltf. to file brief in 2 weeks, Deft. to file answer brief within 2 weeks thereafter. Pltf. to file reply brief within 2 weeks thereafter. The Court to rule on stipulation of facts and parties' briefs. Copies.

March 9, 1984 – 9 – BRIEF of Pltfs.

March 23, 1984 – 10 – Trial Brief of Defts.

March 23, 1984 – 11 – Defts' ANSWER to Pltfs' First Amended Complaint

April 6, 1984 – 12 – REPLY Brief of Pltfs.
file and briefs to Judge

July 18, 1984 – NOTICES mailed for a hearing on oral arguments on briefs set for July 27th at 11

July 27, 1984 – HEARING (WLB) Case called for oral arguments on the briefs. Arguments heard and taken under advisement.

August 29, 1984 – 13 – REPLY to pltfs' supplemental brief (USA)

January 23, 1985 – 14 – ORDER (WLB) that the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to tender it unconstitutional.

January 23, 1985 – 15 – JUDGMENT entered in favor of plaintiff and against defendants

January 23, 1985 – CLOSED JS-6 SI-1 X820

February 21, 1985 – 16 – NOTICE OF APPEAL filed in ESL, recd and EOD in Alton 2-25-85

February 21, 1985—17—DEFTS' Designation of Record on Appeal

February 27, 1985—****—INCORRECT entries, Notice of Appeal was to Supreme Court under 28 USC 1252 Short Record being returned from CCA. Clerk, Supreme Court advised do not send any record until they request. Corrected x820 Telephone #, Supreme Court—202 479 3000

April 18, 1985—*EXTENSION of time granted to USA to docket appeal to and including 6-21-85*

July 5, 1985—18—NOTICE of filing an appeal from Supreme Court, #84-1944, October Term, 1984 x820 (USA, et al. vs. Alvin Hemme, et al.)

August 2, 1985—19—NOTICE of filing an appeal, 85-132, October Term, 1985, (A. Hemme, et al. vs. USA, et al.)

October 11, 1985—20—ORDER (SUPREME COURT) . . . the statement of jurisdiction in this case having been submitted and considered by the Court, in this case probable jurisdiction is noted. DATED 10-7-85. EOD. 10-11-85

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS
SOUTHERN DIVISION

Civil No. 83-5069

ALVIN HEMME, DENNIS HEMME AND RON HEMME, AND FARMERS AND MERCHANTS BANK OF HIGHLAND, A CORPORATION, AS TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI,
PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA AND COMMISSIONER OF INTERNAL REVENUE,
DEFENDANTS

STIPULATION OF FACTS

It is hereby stipulated that for purposes of this case the following statements may be accepted as facts, subject to the right of either party to object to the admission of such facts and exhibits in evidence on the grounds of materiality and relevancy, provided however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated.

1. The plaintiffs, Alvin Hemme, Dennis Hemme and Ronald Hemme are residents of LeMasa, California, and are all citizens of the United States, and all are transferees of Charles W. Hirschi, Deceased.

2. The plaintiff, the Farmers and Merchants Bank of Highland, at all times mentioned in the First Amended Complaint was and now is a corporation organized and existing under the laws of the State of Illinois, engaged in the business of handling trust accounts, and having its principal office and place of business at 1223 Broadway, Highland, Madison County, Illinois, in the Southern District of Illinois.

3. The plaintiff, the Farmers and Merchants Bank of Highland, at all times mentioned in The First Amended Complaint was and now is the trustee of the Revocable Living Trust of Charles W. Hirschi, dated the 9th day of October, 1974, a true copy of which Revocable Living Trust of Charles W. Hirschi is attached hereto as "Exhibit A."

4. The defendants are the United States of America, Department of the Treasury of the United States of America and the Commissioner of Internal Revenue.

5. This action arises under the provisions of the Internal Revenue Code, (26 U.S.C.), and is a suit for the refund of internal revenue taxes brought pursuant to 28 U.S.C., Section 1346(a)(1).

6. On September 28, 1976, Charles W. Hirschi made gifts to five individuals and, thereafter, duly and timely filed a federal gift tax return thereon on September 30, 1976, at the Internal Revenue Office in Kansas City, Missouri. A true copy of said return is attached hereto as "Exhibit B." The decedent elected to apply the specific exemption in the sum of $30,000.00 against the taxable gifts, pursuant to then-existing Internal Revenue Code Section 2521 (26 U.S.C.).

7. Charles W. Hirschi died on November 9, 1978.

8. The plaintiff, the Farmers and Merchants Bank of Highland, as Trustee of the Revocable Living Trust of Charles W. Hirschi, duly and timely filed a federal estate tax return at the Internal Revenue Office in Kansas City, Missouri. A true copy of said return is attached hereto as "Exhibit C."

9. Since the September 28, 1976 gifts were made within three years of the decedent's date of death, which occurred on November 9, 1978, said gifts were included pursuant to Internal Revenue Code Section 2035 in the gross estate of the decedent on the said federal estate tax return as gifts made in contemplation of death.

10. Since said gifts were made during the period from September 8, 1978, to December 31, 1976 (the transitional period), the Internal Revenue Estate Tax Examiner advised per letter dated April 11, 1980 and examination report dated November 19, 1980 that the amount of the unified credit allowable on the decedent's estate tax return would be reduced by $6,000 from $34,000 to $28,000 (20 percent of the pre-1977 specific exemption, i.e., .20 × $30,000 = $6,000), pursuant to Internal Revenue Code Section 2010(c). The Internal Revenue Estate Tax Examiner therefore concluded that there was a deficiency in the estate tax paid in the amount of $6,000.00. True copies of said letter dated April 11, 1980 and Examination Report dated November 9, 1978 are attached hereto as "Exhibit D."

11. On or about September 22, 1980, the plaintiffs duly filed with the defendant a Protest to Conclusions Resulting From Federal Estate Tax Return Examination which said protest contained such information as defendant required, including a summary statement of the grounds upon which the plaintiffs relied and said protest is now on file with the Internal Revenue Service. A true copy of said protest is attached hereto as "Exhibit E."

12. On or about December 15, 1980 the plaintiffs duly filed with defendant a Protest to 30-day Letter, which protest contained such information as defendant required, including a summary statement of the grounds upon which the plaintiffs relied, and said protest is now on file with the Internal Revenue Service. A true copy of said Protest is attached hereto as "Exhibit F."

13. On or about July 27, 1982, the plaintiffs mailed to the Department of Treasury of the United States of America, Internal Revenue Service, Form 4089, Notice of Deficiency Waiver and enclosed a check for $6,000.00 in payment of the deficiency. A true copy of this I.R.S. Form 4089 Notice of Deficiency-Waiver is attached hereto as "Exhibit G."

14. On August 20, 1982 the plaintiffs filed an IRS Form 843, Claim for Refund of Federal Estate Taxes, with the Department of the Treasury of the United States of America, Internal Revenue Service, a copy of which Claim for Refund of Federal Estate Taxes is attached hereto as "Exhibit H."

15. The sole issue to be decided herein is whether the decedent's election to apply the $30,000 specific exemption against the taxable gifts made on September 28, 1976 results in a $6,000 reduction of the unified credit pursuant to Internal Revenue Code Section 2010 (c), where the gifts were included in the decedent's gross estate, for estate tax purposes, pursuant to Internal Revenue Code, Section 2035.

SETH G. HEALD
Trial Attorney
Tax Division
Department of Justice
Washington, D.C. 20530
Telephone: (202) 724-6512
Attorney for the defendants

ALVIN HEMME, DENNIS HEMME AND RON HEMME AND FARMERS AND MERCHANTS BANK OF HIGHLAND, AS TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI
Plaintiffs

By

DONALD C. RIKLI
Attorney for Plaintiffs
914 Broadway
Highland, Illinois 62249
Telephone: (618) 654-2364

8

Form 709 (Rev. Sept. 1975)
Department of the Treasury
Internal Revenue Service

United States Quarterly Gift Tax Return

(Section 6019 of the Internal Revenue Code)

Calendar quarter ending (month and year) ► September, 1976

Donor's first name and middle initial	Donor's last name	Social security number
Charles W.	Hirschi	340-20-9749

Address (number and street)	Residence (domicile)
c/o 914 Broadway	Illinois, U.S.A.

City, State, and ZIP code	Citizenship	Yes	No
Highland, Illinois 62249	U.S.A.		

If you (the donor) filed a previous Form 709, has your address changed since the last Form 709 was filed? . . . . . — X

A Did you (the donor), during the calendar quarter written above (see instruction 1 for treatment of gifts in more than one quarter which aggregate more than $3,000), without adequate and full consideration in money or money's worth, give to any one donee more than $3,000 in value for the calendar year (or regardless of value if a future interest) as follows in items 1 through 8 below: — — X

1(a) by creating a trust for the benefit of a person or persons other than yourself in which you kept no power to revest the beneficial title to the property in yourself or to change the beneficiaries or their proportionate benefits? (If "Yes," attach a copy of the trust instrument.) . . . . . — X

(b) by adding to such type trust previously created? . . . . . — X

(c) by relinquishing every such power that was retained in a previously created trust? . . . . . — X

2 by permitting a beneficiary, other than yourself, to receive the income from a trust you created in which you kept the power to revest the beneficial title to the property in yourself or to change the beneficiaries or their proportionate benefits? . . . . . — X

3(a) by purchasing a life insurance policy with proceeds payable to a beneficiary other than your estate in which you kept no power to revest the economic benefits in yourself or your estate or to change the beneficiaries or their proportionate benefits? . . . . . — X

(b) by paying a premium on such type policy previously issued? . . . . . — X

(c) by relinquishing every such power that you kept in a previously issued policy? . . . . . — X

4 by permitting another to withdraw funds that you deposited in a joint bank account? . . . . . — X

5 by purchasing and/or conveying title to real property to your spouse and yourself as tenants by the entirety or as joint tenants with right of survivorship? (If "Yes," see instruction 9.) . . . . . — X

6 by purchasing and/or conveying title to any other property to another and yourself as joint tenants? . . . . . — X

7 by exercising or releasing a power of appointment? . . . . . — X

8 by any other method, direct or indirect? . . . . . X —

If the answer is "Yes" to any of the foregoing, each gift (other than the creation of a joint tenancy with your spouse in real property with right of survivorship, or addition thereto, which you do not elect to treat as a gift) must be fully disclosed in Schedule A

Gifts by husband or wife to third parties.—Do you consent to have the gifts by you and by your spouse to third parties during the calendar quarter(s) considered as made one half by each of you? (See instruction 8.) . . . . . — X

If the answer is "Yes," the following information must be furnished and the consent shown below signed by your spouse.)

1) Name of spouse	1(b) Social security number
N/A	N/A

If the consent is effective for gifts made in a previous quarter(s) of the calendar year and no return was filed for such previous quarter(s) (see instruction 1) and such gifts are being reported on this return (see instruction 10), write the previous quarter(s) ending (month and year) in addition to the current quarter ending (month and year).

Were you married during the entire calendar quarter(s)? . . . . . — X

If the answer to 3 is "No," check whether [ ] married, [ ] divorced, or [X] widowed, and give date ► 8/4/64

Will a gift tax return for this calendar quarter be filed by your spouse? . . . . . — X

Consent of Spouse.—I consent to have the gifts made by me and by my spouse to third parties during the calendar quarter(s) considered as made one half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.

Spouse's signature ► N/A Date ► N/A

1	Enter the amount from Schedule A, line 1	None
2	Enter the amount from Schedule B, line c	None
3	Total (add amounts on lines 1 and 2)	None
4	Tax computed on amount on line 3 (See "Table for Computing Gift Tax" in separate instructions.) . . .	None
5	Tax computed on amount on line 2 (See "Table for Computing Gift Tax" in separate instructions.) . .	None
6	Balance (subtract amount on line 5 from amount on line 4)	None
7	Credit for foreign gift taxes (see instruction 20)	None
8	Tax due (subtract amount on line 7 from amount on line 6)	None

Please attach the necessary supplemental documents; see instruction 15.

Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. If prepared by a person other than donor, this declaration is based on all information of which the preparer has any knowledge.

Charles W. Hirschi — Charles W. Hirschi — 9-30-76
Signature — Date

Donald C. Dikli — Donald C. Dikli — 9-30-76
Preparer's signature (other than donor) — Date

14 Broadway, Highland, Illinois 62249
Preparer's address (number, street, and ZIP code)

EXHIBIT B

[redacted]DULE A—Computation of Taxable [redacted]

Description of gift and location of property (If real estate, give street address or rural route. If stock, give exact name of issuing corporation. If bonds, give maturity date, interest rate, and name of issuing corporation. If mortgage or note receivable, give date, interest rate, and name of maker. If interest in business, give name and address of business. If gift was disclosed, such as Attorney or Accountant, explain how.)	Donee's Address (Donee of gift)	Date of Gift	Value at date of Gift
(See attached sheet)			

a) Total gifts of donor	45,000.00
(b) One half of items ..... to ..... attributable to spouse (see instruction 11)	None
(c) Balance (subtract amount on line b from amount on line a)	45,000.00
d) Gifts of spouse to be included (from line b of spouse's return) (see instruction 11)	None
e) Total gifts (add amount on lines c and d)	45,000.00
f) Total exclusions not exceeding $3,000 for the calendar year for each donee (except gifts of future interests)	15,000.00
g) Total included amount of gifts (subtract amount on line f from amount on line e)	30,000.00
h) Deductions (see instructions 16, 17, and 18):	
(1) Charitable, public, and similar gifts (based on items ..... to ....., less exclusions)	
(2) Marital deduction (based on items ..... to .....)	
(3) Specific exemption claimed	30,000.00
i) Total deductions (add amounts on lines 1, 2, and 3)	30,000.00
j) Amount of taxable gifts (subtract amount on line i from amount on line g)	None

SCHEDULE B—Returns, Amounts of Specific Exemption, and Taxable Gifts for Prior Periods

Did you (the donor) file gift tax returns for prior periods? ☐ Yes ☒ No

(If "Yes," follow instruction 19 in completing Schedule B below.)

Calendar years (prior to 1971) or calendar quarters (1971 and subsequent years)	Internal Revenue office where prior return was filed	Amount of specific exemption	Amount of taxable gifts
None	None	None	None
a) Totals for prior periods (without adjustment for reduced specific exemption)		None	None
b) Amount, if any, by which total specific exemption, line a, exceeds $30,000 (see instruction 19)			None
c) Total amount of taxable gifts for prior periods (add amount, last column, line a, and amount, if any, line b)			None

(If more space is needed, attach additional sheets of same size.)

☆ U.S. GOVERNMENT PRINTING OFFICE—1975—672-224

[Attachment to Schedule A]

1. The following property:

1 U.S. Treasury Note No. 28558 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 28559 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 28560 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 9816 dated November 6, 1974 due May 15, 1979 for $5,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $196.88 each.

1 U.S. Treasury Note No. 11424 dated November 6, 1974 due May 15, 1979 for $10,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $393.75 each.

Donee: Virginia Hemme
10517 Chickering Drive
St. Louis, Missouri 63136
$18,000.00 9-28-76 $18,000.00

2. The following property:

1 U.S. Treasury Note No. 28555 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 28556 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 28557 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 9726 dated November 6, 1974 due May 15, 1979 for $5,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $196.88 each.

1 U.S. Treasury Note No. 11388 dated November 6, 1974 due May 15, 1979 for $10,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $393.75 each.

Donee: Alvin Hemme
10517 Chickering Drive
St. Louis, Missouri 63136

$18,000.00	9-28-76	$18,000.00

3. The following Property:

1 U.S. Treasury Note No. 28552 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 28553 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 28554 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

Donee: Ronald Hemme
10517 Chickering Drive
St. Louis, Missouri 63136
$3,000.00 9-28-76 $3,000.00

4. The following property:

1 U.S. Treasury Note No. 22216 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 22220 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 22221 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

Donee: Brenda Hemme
11809 Strand Drive Apt. #1
Florissant, Missouri 63033
$3,000.00 9-28-76 $3,000.00

5. The following property:

1 U.S. Treasury Note No. 22276 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 22214 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

1 U.S. Treasury Note No. 22215 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

Donee: Dennis Hemme
11809 Strand Drive Apt. #1
Florissant, Missouri 63033

$3,000.00	9-28-76	$3,000.00

Form 706
(Rev. June 1977)
Department of the Treasury
Internal Revenue Service

United States Estate Tax Return

Estate of citizen or resident of the United States (see separate instructions)
Date of death after December 31, 1976.

IRS use only
Date received

Decedent's first name and middle initial	Decedent's last name	Date of death
CHARLES W.	HIRSCHI	11/9/78
Domicile at time of death	**Year domicile established**	**Decedent's social security number**
Illinois	1889	340-20-9749

Deceased's personal representative or persons in possession of property

Name	Address (Number and street, city, State, and ZIP code)
Farmers & Merchants Bank of Highland, Trustee of Revocable Living Agreement of decedent	1223 Broadway Highland, Illinois 62249

Name and location of court where will was probated or estate administered: No Probate — Case number: ---

If decedent died testate check here ► X and attach a certified copy of the will.

Authorization to receive confidential tax information under 26 C.F.R. 601.502(c)(3)(ii) If return prepared by an attorney on behalf of the deceased's personal representative:
I declare that I am the attorney of record for the deceased's personal representative before the above court, that I prepared this return on behalf of the deceased's personal representative, that I am not currently under suspension or disbarment from practice before the Internal Revenue Service, and that I am currently qualified to practice in the State of Illinois

914 Broadway
Highland, Illinois 62249
(Signature of attorney) Donald C. Rikli (Address (number and street, city, State, and ZIP code)) (Date)

Computation of Tax

1	Total gross estate (from Recapitulation, page 3, line 10)	1	430,021.77
2	Total allowable deductions (from Recapitulation, page 3, line 29)	2	27,779.67
3	Taxable estate (subtract the amount on line 2 from the amount on line 1)	3	402,242.10
4	Adjusted taxable gifts (total amount of taxable gifts (within the meaning of section 2503) made by decedent after December 31, 1976, other than gifts which are includible in decedent's gross estate (section 2001(b)))	4	None
5	Add the amount on line 3 and the amount on line 4	5	402,242.10
6	Tentative tax on the amount on line 5 from Table A in the separate instructions	6	122,562.31
7	Aggregate gift taxes payable with respect to gifts by decedent after December 31, 1976, including gift taxes paid by decedent's spouse for split gifts (section 2513) if decedent was the donor of such gifts and they are includible in decedent's gross estate	7	None
8	Subtract the amount on line 7 from the amount on line 6	8	122,562.31
9	Unified credit against estate tax from Table B in the separate instructions	9	34,000.00
10	Adjustment to unified credit (20% of aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by decedent after September 8, 1976)	10	None*
11	Allowable unified credit (subtract the amount on line 10 from the amount on line 9)	11	34,000.00
12	Subtract the amount on line 11 from the amount on line 8 (but not less than zero)	12	88,562.31
13	Credit for State death taxes not to exceed the amount on line 12; see Table C in the separate instructions and attach credit evidence	13	6,871.75
14	Subtract the amount on line 13 from the amount on line 12	14	81,690.56
15	Credit for Federal gift taxes (see section 2012 and attach computation)	15	
16	Credit for foreign death taxes (from Schedule P). (Form 706CE is required)	16	
17	Credit for tax on prior transfers (from Schedule Q)	17	
18	Total (add the amounts on lines 15, 16, and 17)	18	None
19	Subtract the amount on line 18 from the amount on line 14	19	81,690.56
20	Prior payments. Explain in attached statement; see instruction 5	20	
21	United States Treasury bonds redeemed in payment of estate tax	21	55,503.39
22	Total (add the amount on line 20 and the amount on line 21)	22	55,503.39
23	Balance due (subtract the amount on line 22 from the amount on line 19)	23	26,187.17

Note: Please attach the necessary supplemental documents; see instruction 6.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer other than decedent's personal representative or person in possession of property is based on all information of which he has any knowledge.

FARMERS & MERCHANTS BANK OF HIGHLAND, Trustee
By
Signature of decedent's personal representative or person in possession of property — Trust Officer — Date

914 Broadway
Highland, Illinois 62249
Signature of preparer other than decedent's personal representative (also give address) — Date

DONALD C. RIKLI

EXHIBIT C

14

Form 706 (Rev. 6-77)

15

Estate of: CHARLES W. HIRSCHI, Deceased.

SCHEDULE G—Transfers During Decedent's Life

	Yes	No
1 Did the decedent make any transfer described in the first paragraph (including the six subparagraphs) of the separate instructions for this schedule?	X	
2a Did the decedent, at any time, make a transfer (other than an outright transfer not in trust) without an adequate and full consideration in money or money's worth, but not believed to be includible in the gross estate as indicated in the first paragraph (including the six subparagraphs) of the separate instructions for this schedule?	X	
If "Yes," furnish the following information:		
2b Date: See Attached Schedule / 2c Amount or value / 2d Character of transfer		
3a Did the decedent, before January 1, 1977, and within 3 years immediately preceding death, make any transfer of property without an adequate and full consideration in money or money's worth?	X	
If "Yes," furnish the following information:		
3b Date: See attached schedule / 3c Amount or value / 3d Character of transfer		
3e Motive which actuated decedent in making the transfer: To make gifts		
3f Names and addresses of hospitals in which decedent was confined within 3 years of death: St. Joseph's Hospital, 1515 Main Street, Highland, Il. 62249		
4 Were there in existence at the time of the decedent's death any trusts created by decedent during decedent's lifetime?	X	
5a Have several gift tax returns ever been filed?	X	
If "Yes," furnish the following information:		
5b Period(s) covered: 9/76;12/77;3/78 / 5c Internal Revenue office(s) where filed: Kansas City, Missouri		

Item Number	Description and stock CUSIP number if available	Alternate valuation date	Alternate value	Value at date of death
	A. Transfers by decedent after December 31, 1976, and within 3 years of death unless excepted under section 2035(b):			
1	None			
	Gift tax paid by decedent or estate for above gifts made by decedent or spouse after December 31, 1976, and within 3 years of decedent's death	x x x x x	x x x x x	None.
	B. Other transfers:			
1	9-28-76, Treasury Notes to Virginia Hemme, daughter, described as follows: 1 U. S. Treasury Note No. 28558 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each; 1 U. S. Treasury Note No. 28559 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each; 1 U. S. Treasury Note No. 28560 dated November 6, 1974 due May 15, 1979 for			
	TOTAL (Also enter under the Recapitulation, page 3.)			

(If more space is needed, insert additional sheets of same size.)

Estate of CHARLES W. HIRSCHI, Deceased.
Schedule G, Continued:

$1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 9816 dated November 6, 1974 due May 15, 1979 for $5,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $196.88 each;

1 U.S. Treasury Note No. 11424 dated November 6, 1974 due May 15, 1979 for $10,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $393.75 each.

Value: $18,000.00

2. 9-28-76, Treasury Notes to Alvin Hemme, Son-in-law, described as follows:

1 U.S. Treasury Note No. 28555 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 28556 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 28557 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 9726 dated November 6, 1974 due May 15, 1979 for $5,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $196.88 each;

1 U.S. Treasury Note No. 11388 dated November 6, 1974 due May 15, 1979 for $10,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $393.75 each.

Value: 18,000.00

3 9-28-76, Treasury Notes to Ronald Hemme, Grandson, described as follows:

1 U.S. Treasury Note No. 28552 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 28553 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 28554 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

Value: 3,000.00

4 9-28-76, Treasury Notes to Brenda Hemme, spouse of grandson, described as follows:

1 U.S. Treasury Note No. 22216 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 22220 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 22221 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

Value: 3,000.000

5 9-28-76, Treasury Notes to Dennis Hemme, grandson, described as follows:

1 U.S. Treasury Note No. 22276 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 22214 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each;

1 U.S. Treasury Note No. 22215 dated November 6, 1974 due May 15, 1979 for $1,000.00 with Coupon due May 15, 1977 and subsequent coupons attached at $39.38 each.

Value: 3,000.00

The following listed property held by Farmers & Merchants Bank of Highland, Trustee of Revocable Living Trust Agreement of decedent dated October 9, 1974:

6 Lots Numbered 9 and the East One-Half (1/2) of Lot Numbered 10 in Block Number 8 of the Original Town (now City) of Highland as the same appears from plat thereof recorded in the Recorder's Office of Madison County, Illinois, in Plat Book 4 Page 40, situated in the City of Highland, County of Madison and State of Illinois;

Improvements: Two Family Apartment, 2-story brick, basement, garage

Title: Fee simple, deemed perfect

Encumbrances: None, except current taxes

Value: 44,000.00

7 Farmers & Merchants Bank of Highland, cash 683.14

8 First National Bank of Nashville, T/C/D #2108 22,000.00

8a Accrued interest on Item 8 811.16

9 The following T/C/D's of First National Bank of Highland:

Cert. No.	Amount	Accrued Interest	Total
AR16343	1,025.00	27.07	1,052.07
18174	4,000.00	7.47	4,007.47
			5,059.54

10 The Following T/C/D's of Farmers & Merchants Bank of Highland:

Cert. No.	Amount	Accrued Interest	Total
47908	1,000.00	25.00	1,025.00
48631	10,000.00	116.58	10,116.58
49777	10,000.00	63.18	10,063.18
48527	1,976.41	36.59	2,013.00
48349	5,000.00	176.01	5,176.01
48653	3,842.51	44.82	3,887.33
			32,281.10

Form **843**
(Rev. October 1981)
Department of the Treasury
Internal Revenue Service

Claim

▶ See instructions on back

OMB No. 1545-0024
Expires 12-31-83

20

If your claim is for an overpayment of income taxes, do NOT use this form (see instructions)

Please print or type

Name of taxpayer or purchaser of stamps
CHARLES W. HIRSCHI, Deceased.

Number and street
c/o Farmers & Merchants Bank of Highland, Trustee, / 1223 Broadway

City or town, State, and ZIP code
Highland, IL 62249

Fill in applicable items—Use attachments if necessary

1 Your social security number
340-20-9749

2 Employer identification number

3 Internal Revenue Service Center where return (if any) was filed
Kansas City, MO

4 Name and address shown on return, if different from above
N/A

5 Period—prepare separate form for each tax period
From , 19 , to , 19

6 Amount to be refunded or abated
$ 6,000.00

7 Dates of payment
7/27/82

8 Type of tax
☐ Employment ☒ Estate ☐ Excise ☐ Gift ☐ Stamp

9 Kind of return filed
☒ 706 ☐ 709 ☐ 720 ☐ 940 ☐ 941 ☐ 990-PF ☐ 4720 ☐ Other (specify) ▶

10 If this claim involves refund of excise taxes on gasoline, special fuels or lubricating oil, please indicate your tax year for income tax purposes N/A

11 Explain why you believe this claim should be allowed and show computation of tax refund or abatement

See attached statement

Under penalties of perjury, I declare that I have examined this claim, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Signed By FARMERS & MERCHANTS BANK OF HIGHLAND, Trustee
Trust Officer
Dated 8/1t 19 82

Director's Stamp
(Date received)

For Internal Revenue Service Use Only

☐ Refund of taxes illegally, erroneously, or excessively collected.
☐ Refund of amount paid for stamps unused, or used in error or excess.
☐ Abatement of tax assessed (not applicable to estate or gift taxes).

20

For Paperwork Reduction Act Notice, see instructions on back.

Form 843 (Rev. 10-81)

EXHIBIT H

20

STATEMENT TO BE ATTACHED TO CLAIM OF THE ESTATE OF CHARLES W. HIRSCHI, DECEASED:

Schedule G of the decedent's Federal Estate Tax return (Form 706) shows that the decedent made a transfer of land and Treasury Notes on September 28, 1976, which was within three (3) years of the date of death of said decedent. As a consequence, pursuant to I.R.C. Section 2035, this transfer is included in the estate of said decedent and is shown under paragraph B of said Schedule G.

This gift was also made during the transitional period from 9/8/76 to 12/31/76, when, pursuant to I.R.C. Section 2010(c), the unified credit would be reduced by 20% of the pre-1977 specific exemption (.20 × $30,000 = $6,000) as a result of the making of such a gift. It is the position of this estate that it was not the intention of the drafters of the Internal Revenue Code that both the amount of the gift be included in the estate *and* the unified credit be reduced by 20% of the pre-1977 specific exemption under Section 2010(c), but it was the intention of the drafters of the Internal Revenue Code that in the event of the occurrences which are involved in this case, the gross estate would include all of the gift in contemplation of death and the unified credit against estate tax would not be reduced by 20% of the pre-1977 specific exemption.

In essence, such inequitable treatment results in double taxation. Section 2010 allows a unified credit for every estate against the tax imposed by Section 2001. Section 2001 imposes a tax upon the *transfer* of the taxable estate. The tax is calculated by imposing a tentative tax on the sum of the taxable estate and the amount of the adjusted taxable gifts over the aggregate amount of tax payable under Chapter 12 with respect to gifts made by the decedent after 1976. Under Section 2001,"adjusted taxable gifts" means the total amount of taxable gifts (within the meaning of 2503) made by the decedent after Decem-

ber 31, 1976, OTHER THAN GIFTS WHICH ARE INCLUDIBLE IN THE GROSS ESTATE OF THE DECEDENT. Such a specific "exclusion" was made for gifts already included in the gross estate under the Reform Act of 1976. This "exclusion" prevents a double taxation of gifts. A similar provision should have been added to Section 2010(c) to avoid the inequitable tax treatment which results under 2010(c) when the gift is included in the gross estate and is not reduced by the full $30,000.00 exemption. Furthermore, it is inequitable that an exemption of $30,000.00 should be allowed in tax years 1975 and 1977 but not during the period of September 8 through December 31, 1976.

Section 2001 provides for a 34% rate of tax upon the top bracket of the estate of Charles Hirschi. The tax imposed by Section 2001 is calculated upon the gross estate which includes, under Section 2035, the transfers made on September 28, 1976. Though the process of inclusion of these transfers in the gross estate, and a reduction in the allowable unified credit, the effect results in a doubling of the 34% rate of tax. Furthermore, there is no statute which provides for Section 2035 inclusion and double taxation.

In the alternative, it doubles the amount subject to the same rate and thus results in an unjust enrichment for the benefit of the government in the amount of $6,000.00. The imposition of an unwarranted burden of tax in the amount of $6,000.00 thus penalizes the unfortunate transferor who made gifts within the period between September 20, 1976 and December 31, 1976, and also died within 3 years of the time of the gift.

In the Supreme Court of the United States

No. 84-1944

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

APPEAL from the United States District Court for the Southern District of Illinois.

The statement of jurisdiction in this case having been submitted and considered by the Court, in this case probable jurisdiction is noted.

OCTOBER 7, 1985

Supreme Court, U.S.
FILED
NOV 27 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1944

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

ALBERT G. LAUBER, JR.
Assistant to the Solicitor General

MICHAEL L. PAUP
ERNEST J. BROWN
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether, in computing the federal estate tax payable by the estate of a decedent who died on November 9, 1978, amendments to the federal tax laws passed by both houses of Congress on September 16, 1976, and approved by the President on October 4, 1976, may constitutionally be applied to ascertain the effect of gifts made by the decedent on September 28, 1976, and of an election made by him in a federal gift tax return filed on September 30, 1976.

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 84-1944

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The order of the district court (J.S. App. 1a-6a) is unreported.

JURISDICTION

The judgment of the district court (J.S. App. 7a) was entered on January 23, 1985. A notice of appeal to this Court (J.S. App. 8a) was filed on February 21, 1985. On April 16, 1985, Justice Stevens extended the time for docketing the appeal to and including June 21, 1985. The jurisdictional statement was filed on that date, and probable jurisdiction was noted on October 7, 1985 (J.A. 23). The jurisdiction of this Court is invoked under 28 U.S.C. 1252. A direct appeal lies where, as here, a federal statute

has been held unconstitutional as applied. *United States* v. *Darusmont*, 449 U.S. 292, 293 (1981) (per curiam).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant constitutional and statutory provisions are set forth in the appendix to the jurisdictional statement (J.S. App. 9a-11a).

STATEMENT

In 1976, Congress significantly changed the relationship between the federal gift tax and the federal estate tax. Previously, a taxpayer had been entitled to a lifetime "specific exemption" of $30,000 for gift-tax purposes, and his estate had been entitled to an exemption of $60,000 for estate-tax purposes. In 1976 Congress brought a measure of unification to the gift tax and the estate tax, and in the course of doing so it replaced those two separate exemptions with a single "unified credit," which was made available against either or both taxes, as first incurred. In an effort to produce an orderly transition from the earlier tax regime to the later, Congress provided that a person (or the estate of a person) who had claimed some or all of his lifetime "specific exemption" for certain gifts could not later claim the full "unified credit" against the gift or estate tax. Rather, the "unified credit" in such circumstances was required to be reduced to reflect the transfer tax benefit that the transferor had already garnered. The district court held that this transitional rule as applied in this case was a species of retroactive legislation, and that it was so arbitrary and capricious as to render it unconstitutional under the Due Process Clause of the Fifth Amendment.

A. The Statutory Framework

1. Prior to 1977, the estate tax and the gift tax, while functionally related, were separately imposed, separately administered, and separately collected. The gift tax was and is recurrent (*i.e.*, imposed and collected on an annual or quarterly basis) and, to guarantee progressivity, it has always been cumulative. The cumulation is accomplished by aggregating all taxable gifts made by a taxpayer after June 6, 1932, and through the taxable period in which subsequent gifts are made, in order to determine the tax rate or "bracket" applicable to a particular gift. See 26 U.S.C. 2502.[1] The gift tax provided an annual per-donee exclusion in a fixed dollar amount; in 1976, the exclusion was $3,000 per donee. 26 U.S.C. (1976 ed.) 2503(b).[2] The gift tax also provided a lifetime "specific exemption"—basically a deduction—in the amount of $30,000 (26 U.S.C. (1970 ed.) 2521). A taxpayer could claim the specific exemption, in whole or in part, whenever he chose.

The estate tax, of course, has never been recurrent, but is imposed at graduated rates on the "taxable estate" (26 U.S.C. 2051). The taxable estate has always been defined to include, not only property owned by the decedent at his death, but also certain property

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[1] The cumulation begins with June 6, 1932, the date the present gift tax was imposed. Revenue Act of 1932, ch. 209, Tit. IV, 47 Stat. 245 *et seq.* A noncumulative gift tax had previously been imposed by the Revenue Act of 1924, ch. 234, 43 Stat. 253 *et seq.*; it was repealed by the Revenue Act of 1926, ch. 27, § 1200(a), 44 Stat. 125.

[2] The $3,000-per-donee annual exclusion was established by the Revenue Act of 1942, ch. 617, § 454, 56 Stat. 953. It has since been increased to $10,000. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 441(a), 95 Stat. 319.

that he may have transferred during life, or which is subject to transfer under specified circumstances relating to his death. In 1976, the estate tax provided a $60,000 exemption—again, basically a deduction—in determining the taxable estate (26 U.S.C. (1970 ed.) 2052).

Although the gift tax and the estate tax were separate in most aspects, and although gift tax rates prior to 1977 were only 75% of estate tax rates on comparable transfers, the two taxes were never entirely unconnected. From the beginning, it was clear that some property, the lifetime transfer of which was subject to the gift tax, might also be includable in the transferor's estate for estate tax purposes. Common examples were gifts in contemplation of death (26 U.S.C. (1970 ed.) 2035) and transfers with a retained life interest (26 U.S.C. (1970 ed.) 2036). To alleviate the double tax burden in such situations, Congress provided that, where the transfer of property includable in the gross estate had previously been subject to gift tax, a credit was allowable against the estate tax for the gift tax paid (26 U.S.C. (1970 ed.) 2012).[3]

2. In the Tax Reform Act of 1976, Pub. L. No. 94-455, Tit. XX, 90 Stat. 1846 *et seq.*, Congress substantially integrated the estate tax and the gift tax without greatly altering the coverage of either. The first step was to bring the two rate structures into conformity. This was done by making gift tax rates

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[3] Because of possible differences in value at the time of the gift and at the time of decedent's death, differences in the amounts of the taxable estate and of the aggregate of taxable gifts, and differences in rates and structures, computation of the gift tax credit may be complex, to say the least. See Treas. Reg. § 20.2012-1 (1970).

equal to estate tax rates.[4] Then, in lieu of the $30,000 specific exemption from the gift tax and the $60,000 exemption from the estate tax, Congress created, not an exemption or deduction, but a credit against the taxes imposed, termed the "unified credit," available against either or both taxes as first incurred.[5] Finally, a somewhat intricate mechanism for a degree of unification was supplied by providing that the estate tax should be determined (subject to the "unified credit") by a computation that first aggregated the taxable estate and taxable gifts made after December 31, 1976; computed a tax on that aggregate sum; and then reduced the result by the gift tax payable on the gifts thus included.[6] Roughly speaking, the result was to treat the taxable estate as the "ultimate taxable gift." See generally J. McCord, *1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary* (1977).

The 1976 Act was effective with respect to estates of decedents dying after December 31, 1976, and with respect to gifts made after that date. But while the Act inaugurated a measure of integration, it did not purport to provide a completely fresh start, and could hardly have done so. Continuity with the past necessarily had to be provided for. The estate of a decedent dying after 1976, for example, would continue

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[4] Pub. L. No. 94-455, § 2001(b)(1), 90 Stat. 1849 (amending 26 U.S.C. 2502(a)).

[5] Pub. L. No. 94-455, § 2001(a)(2), (3) and (4), 90 Stat. 1848 (adding 26 U.S.C. 2010, amending 26 U.S.C. 2012 and repealing 26 U.S.C. (1970 ed.) 2052); Pub. L. No. 94-455, § 2001(b)(2) and (3), 90 Stat. 1849 (adding 26 U.S.C. 2505 and repealing 26 U.S.C. (1970 ed.) 2521).

[6] Pub. L. No. 94-455, § 2001(a)(1), 90 Stat. 1846 (amending 26 U.S.C. 2001).

in many cases to include assets that he had disposed of before 1977, such as property transferred in contemplation of death or with a retained life interest. Where such prior transfers had been subject to gift tax, the gift tax previously paid would produce a credit against the post-1976 estate tax. And because the gift tax itself remained recurrent and cumulative, gifts made before 1977 continued to affect the impact of the new and higher gift tax rates applicable to gifts made during or after that year. See 26 U.S.C. 2501(a), 2502.

Most relevant for present purposes, a nettlesome question of continuity arose from the fact that the $30,000 specific exemption from the gift tax, which a taxpayer could have employed at the time or times of his choice, was, together with the $60,000 exemption from the estate tax, to be repealed, and the new "unified credit," applicable against either or both taxes, substituted therefor. Obviously, some taxpayers would have employed all or part of the $30,000 specific exemption against pre-1977 gifts. The question was whether that fact should call for an adjustment in the unified credit that they or their estates might subsequently claim.

The bill reported by the House Ways and Means Committee on August 6, 1976, answered that question in the affirmative. It provided that if the specific exemption had been claimed in whole or in part by a taxpayer after June 6, 1932, the unified credit otherwise allowable was to be reduced by 20% of the amount so claimed. H.R. 14844, 94th Cong., 2d Sess. §§ 2010(c), 2505(c) (1976) (set forth at H.R. Rep. 94-1380, 94th Cong., 2d Sess. 94, 131 (1976)). The Committee explained its proposal as follows (H.R. Rep. 94-1380, *supra*, at 16):

> As a transitional rule, the unified credit allowable is to be reduced by an amount equal to 20 percent of the amount allowed as a specific exemption in computing taxable gifts under present law. Thus, in the case where a donor had benefited from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit allowable would be reduced by $6,000.

Although the legislative history does not address the matter, the 20% figure was apparently chosen because it was thought to approximate the average effective gift tax rate, and thus to represent the average transfer tax benefit realized by persons who previously had claimed and been allowed some or all of the specific exemption.

The Conference Committee, in adding provisions of H.R. 14844 to the pending Tax Reform Act of 1976, limited the scope of this transitional rule. It agreed with the House that the new unified credit should be reduced on account of certain gifts as to which the specific exemption had been claimed. However, it decided that the reduction in the unified credit should operate, not in the case of all gifts made after June 6, 1932, but only in the case of gifts made after September 8, 1976—the date the Conference Committee approved the measure. The Committee reports do not explain the reason for thus limiting the scope of the transitional rule.[7] But the transitional rule, with the limitation added in conference, has uniformly

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[7] Each report states simply that "the unified credit is not to be reduced for any amount allowed as a specific exemption for gifts made prior to September 9, 1976." H.R. Conf. Rep. 94-1515, 94th Cong., 2d Sess. 607-608 (1976); S. Conf. Rep. 94-1236, 94th Cong., 2d Sess. 607-608 (1976).

been understood to serve the objective of removing the incentive to make large gifts during the period between September 8, 1976, and January 1, 1977—gifts that otherwise would have provided a double tax benefit in the form of a $30,000 specific exemption under the old regime coupled with an undiminished unified credit under the new. See *Estate of Gawne* v. *Commissioner*, 80 T.C. 478, 483 (1983); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* ¶ 3.02, at 3-4 n.9 (5th ed. 1983); J. McCord, *supra*, § 2.13, at 26.

The Tax Reform Act of 1976, incorporating the limited transitional rule described above, was passed by both Houses of Congress on September 16, 1976. It was signed by the President on October 4, 1976. The transitional rule is currently codified in 26 U.S.C. 2010(c) and 2505(c).

B. The Proceedings In This Case

The facts were stipulated (J.A. 4-22), and the case was submitted to the district court on those stipulated facts (J.S. App. 2a). On September 28, 1976, Charles Hirschi made gifts aggregating $45,000 in value to five persons (*ibid.*). Two days later, he reported those gifts on a federal gift tax return, which indicated no tax due (*id.* at 2a-3a; J.A. 5, 8-13). The first $15,000 of his gifts, consisting of $3,000 transfers to each of the five recipients, was exempt from gift tax by virtue of the annual per-donee exclusion (26 U.S.C. (1970 ed.) 2503(b)). As to the $30,000 balance, Hirschi elected to apply the full amount of his lifetime "specific exemption," thus eliminating any tax (J.S. App. 2a; J.A. 5, 8-13).

Slightly more than two years later, on November 9, 1978, Hirschi died (J.S. App. 2a; J.A. 5). Appellee

Farmers & Merchants Bank filed a federal estate tax return on behalf of the estate (J.A. 5, 14). On Schedule G of that return, which is entitled "Transfers During Decedent's Life," appellee included in the gross estate, as transfers in contemplation of death, the $45,000 in gifts that Hirschi had made on September 28, 1976 (J.S. App. 2a; J.A. 6, 15-18). The estate claimed a unified credit of $34,000, the maximum amount allowable for estates of decedents dying in 1978. J.S. App. 2a; J.A. 14; see 26 U.S.C. (1976 ed.) 2010(b). On audit, the Internal Revenue Service determined that, since Hirschi had claimed a $30,000 specific exemption for gifts made after September 8, 1976, and before January 1, 1977, the unified credit allowable to his estate was required to be reduced by $6,000—20% of the $30,000 specific exemption previously claimed—under the transitional rule of Section 2010(c). The Commissioner accordingly proposed a deficiency in federal estate taxes in the amount of $6,000 (J.S. App. 2a; J.A. 6).

Appellees paid the $6,000 deficiency in July 1982. The following month, they filed a claim for refund of the tax thus paid (J.S. App. 2a; J.A. 7). Although the theory set forth in their refund claim was not entirely clear, they appeared to contend that, since the property that Hirschi had transferred in September 1976 had been included in the gross estate, Section 2010(c) should be interpreted so as not to require any reduction in the unified credit, even though Hirschi had elected to claim the $30,000 specific exemption with respect to those gifts (J.A. 20-22). Appellees argued that "it was not the intention of the drafters of the Internal Revenue Code" to require reduction of the unified credit in these circumstances, and asserted that the Commissioner's construction of

Section 2010(c) to require such a reduction produced "inequitable treatment" that "[i]n essence * * * results in double taxation" (J.A. 21).

Following the denial of their claim for refund, appellees brought this refund suit in the United States District Court for the Southern District of Illinois (J.S. App. 2a; J.A. 1). They again asserted that Section 2010(c) should be construed so as not to call for any reduction in the unified credit under the circumstances of this case. In a supplemental brief, appellees contended alternatively that, if Section 2010(c) were applied to require reduction of the unified credit on account of gifts made before the statute's enactment on October 4, 1976, it would to that extent be retroactive, and would on that ground violate the Fifth Amendment by depriving them of property without due process of law.[8]

The district court recited that "[t]he first issue raised by the plaintiffs which we will address concerns whether the retroactive provision of [26 U.S.C.] 2010 is unconstitutional and thus violates the due process clause of the Fifth Amendment" (J.S. App. 3a). The court acknowledged (*id.* at 3a-4a) that this Court has frequently upheld retroactive application of income tax legislation, but, on the asserted authority of *Shanahan* v. *United States*, 447 F.2d 1082 (10th Cir. 1971), concluded that those decisions do not apply to transfers subject to the estate and gift taxes.

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[8] Appellees' claim of unconstitutionality was based upon the undisputed facts, and the government did not contend that their argument represented an improper variance from the theory set forth in their administrative claim for refund. Cf. *Angelus Milling Co.* v. *Commissioner*, 325 U.S. 293 (1945); *Scovill Mfg. Co.* v. *Fitzpatrick*, 215 F.2d 567 (2d Cir. 1954). See Stip. para. 15 (J.A. 7).

Rather, the court said, this case was controlled by *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), where the Court held that the federal gift tax, newly imposed in 1924, could not constitutionally be applied to gifts completed before its enactment. The district court acknowledged that, in *Milliken* v. *United States*, 283 U.S. 15 (1931), this Court subsequently upheld the constitutionality of an amended estate tax statute as applied to a previously-completed gift in contemplation of death, even though the amendment worked to the estate's disadvantage by imposing higher tax rates and requiring the previously-transferred property to be valued at a higher figure. But the district court found *Milliken* "distinguishable from the case at bar" and held that "the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional" (J.S. App. 5a, 6a). Accordingly, and without discussing their statutory construction argument, it entered judgment for appellees (*id.* at 7a).

SUMMARY OF ARGUMENT

The transitional rule incorporated in Section 2010(c) was designed to accomplish an orderly transition to the new estate-and-gift-tax regime that Congress enacted in 1976. The district court held that this transitional rule, as applied to appellees, was a species of retroactive legislation, and that its operation was so harsh as to deprive them of property without due process of law. The district court was wrong for at least four independent reasons.

First, the statute did not deprive appellees of property. As they concede (Mot. to Dis. 6), the overall effect of the Tax Reform Act of 1976, including Section 2010(c), was to "reduce[] the decedent's estate

tax by $655.16." This diminution of their tax liability can scarcely be called a deprivation of property.

Second, the statute was not "retroactive" legislation. The estate tax amendment that appellees challenge was enacted more than two years before the testator died. The amendment did require that, in computing the estate tax in 1978, his executors take into account the fact that he had claimed the specific exemption in 1976. But this Court has repeatedly rejected the idea that a tax is "retroactive" merely because its operation depends on facts or conditions that came into existence previously. Indeed, the operation of the estate tax regularly depends on actions that the decedent may have taken many years before his death. In characterizing Section 2010(c) as "retroactive" legislation, therefore, the district court evaluated its constitutionality under an erroneous premise.

Third, even if Section 2010(c) could properly be called a "retroactive" statute, its application to appellees was not "so harsh and oppressive as to be a denial of due process" (*United States* v. *Darusmont*, 449 U.S. 292, 299 (1981)). Its lack of harshness is particularly evident here, since the overall effect of the 1976 estate tax amendments was to save appellees money. More generally, the purpose of the transitional rule was to prevent taxpayers (or the estates of taxpayers) who had claimed the specific exemption under the old tax regime from deriving a double tax benefit from an unreduced "unified credit" under the regime that Congress enacted in 1976. The possibility of such a double tax benefit arose from the fact that the unified credit was a *substitute* for the specific exemption. It is well settled that due process is satisfied upon a "showing that the retroactive application

of the legislation is *itself* justified by a rational legislative purpose." *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, No. 83-245 (June 18, 1984), slip op. 12 (emphasis added). The transitional rule involved here clearly represented a rational exercise of Congress's taxing power.

Finally, the decedent in this case "had ample advance notice" (*United States* v. *Darusmont*, 449 U.S. at 299) of the proposed change in the tax laws. The key congressional committees had issued reports explaining the transitional rule, and the bill in which it was incorporated had passed both houses of Congress, before the decedent made the gifts at issue. He thus had constructive if not actual notice of what the effect of claiming the specific exemption was likely to be.

ARGUMENT

THE TRANSITIONAL RULE INCORPORATED IN SECTION 2010(c) IS VALID AS APPLIED TO APPELLEES

A. There Is No Merit To Appellees' Statutory Argument, Or To Their Related Assertion That Section 2010(c) As Applied To Them Results In Double Taxation

Before addressing appellees' constitutional claim, it seems appropriate to dispel any confusion that may have arisen from certain statements that they made in their claim for refund, and again in their motion to dismiss. In their claim for refund, appellees asserted that Section 2010(c) as applied to them "results in double taxation" (J.A. 21). By this they appeared to mean that the effect of Section 2010(c) was to tax *twice* the property that the decedent transferred on September 28, 1976—first under the gift tax, and then, when the property was included in the

decedent's estate as a transfer in contemplation of death, again under the estate tax. Alternatively, appellees asserted that the inclusion of that property in the gross estate, when combined with the reduction in the allowable unified credit under Section 2010(c), "[in] effect results in a doubling of the 34% rate of [estate] tax" (J.A. 22). Appellees repeat both assertions, using slightly different words, in their motion to dismiss (Mot. to Dis. 6, 7).

There is no factual basis for these statements. The single tax that was assessed and paid with respect to the property transferred by the decedent in September 1976 was the estate tax paid after decedent's death in November 1978. No tax was paid with respect to the transfer of that property in 1976 because the decedent elected to apply the gift tax specific exemption of $30,000. That exemption, coupled with the applicable annual exclusions, meant that no gift tax was paid or payable with respect to the $45,000 transferred. When the property was subjected to estate tax by reason of the decedent's death in 1978, moreover, it was taxed, as the balance of his taxable estate in excess of $250,000 was taxed, at the marginal estate tax rate of 34%. See 26 U.S.C. (1976 ed.) 2001(c); J.A. 14. Appellees' assertions that the same property was taxed twice, or at double rates, are thus squarely contrary to fact.

In reality, appellees' assertions about "double taxation" and "double tax rates" are a factually erroneous way of characterizing—indeed, one might say, of dramatizing—the statutory construction argument that they presented first in their claim for refund and then to the district court. They argued that it would be "inequitable" to reduce the estate's unified credit on account of the decedent's 1976 gifts, even though

he had claimed and had been allowed the $30,000 specific exemption from gift tax with respect to those gifts, because he had the misfortune to die within the next three years, with the result that the property ended up being subject to tax anyway—albeit to estate tax rather than to gift tax—as a transfer in contemplation of death. See J.A. 21-22. In essence, appellees argued that they derived no benefit from the specific exemption, and hence that it would "penalize[] the unfortunate transferor" and his estate to invoke Section 2010(c) against them (J.A. 22). They accordingly urged that the statute be interpreted as inapplicable in these circumstances.

Appellees' statutory construction argument is meritless. The district court, while not addressing that argument specifically, rejected it sub silentio in reaching the merits of their constitutional claim. And their statutory argument has been explicitly rejected by the only other court that has considered it. *Estate of Renick* v. *United States*, 687 F.2d 371, 376-377 (Ct. Cl. 1982). On facts substantially identical to those here, the Court of Claims found meritless the contention "that § 2010(c) should be construed so that the reduction in the unified credit is restored when the gift is included in the gross estate [as a transfer in contemplation of death] pursuant to § 2035" (687 F.2d at 377). "The plain language and legislative design of § 2010(c)," the court noted, "show that Congress intended the reduction to the unified credit to occur in *all* cases where gifts were made during the transition period and the specific gift tax exemption * * * was taken by the donors" (687 F.2d at 376 (emphasis in original)). The court squarely rejected the notion that "Congress intended to reduce the unified credit only if the taxpayer had benefited" from

the exemption (*id.* at 377). "When the decedent made the gift," the court observed, "it *appeared* that he would benefit" from the exemption, and that appearance failed to become a reality only because of his untimely death (*ibid.* (emphasis added)). Although the decedent's untimely death might thus be said to have worked something of a tax advantage to his estate, the Court of Claims correctly refused to find that circumstance a sufficient justification to "imply an exception to the statute" that Congress did not provide (*id.* at 376).

Contrary to appellees' contention, moreover, the situation in which they find themselves is not "inequitable" at all. Prior to 1977, there had always been an element of gamble in a taxpayer's decision about whether and when to elect the $30,000 gift tax exemption. Since the gift tax was cumulative and progressive, with pre-1977 gift tax brackets ranging from 2¼% to 57¾% (26 U.S.C. (1976 ed.) 2502), it made economic sense for a taxpayer who contemplated making substantial gifts to defer claiming the exemption, since it would eliminate considerably more in gift taxes if applied against later gifts subject to tax in the higher brackets than if it were applied to earlier gifts subject to tax in the lower brackets. Deferring the election, on the other hand, created the alternative risks that the taxpayer would die before ever claiming it, or that he would fail to survive for three years after claiming it, in which case the gift as to which it was claimed would be included in his gross estate as a transfer in contemplation of death. In either of the latter events, the specific exemption would basically be wasted.

In this case, as matters eventuated, it would have been better for Hirschi and his estate had he not claimed the specific exemption for the gifts he made

on September 28, 1976, but had rather paid the $2,250 in gift tax that would then have been due. See 26 U.S.C. (1970 ed.) 2502. In that event, his estate would have had credited against the estate tax the $2,250 gift tax paid (26 U.S.C. 2012), and would have enjoyed an unreduced unified credit of $34,000. On the other hand, had Hirschi survived three years after making his gifts, the $45,000 in property that he gave away in 1976 would have been excluded from his taxable estate, and the estate tax due from his executors would have been reduced accordingly. See 26 U.S.C. (1976 ed.) 2001. As appellees acknowledge (Mot. to Dis. 8), Hirschi's gift tax return for the third quarter of 1976 was not due until November 15 of that year. But for his unusual haste, therefore, in filing his return two days after making his gifts, he could have waited a week to see if the President signed the 1976 Act, and then computed the relative advantages and disadvantages of claiming the exemption, in view of the uncertainties of life. If the situation in which appellees find themselves is "inequitable," in other words, the inequity stems, not from the Internal Revenue Code, but from the fact of human mortality.

B. The Application Of The 1976 Act To The Hirschi Estate Did Not Deprive Appellees Of Property

Although the decedent in this case died in November 1978, the district court characterized the application of the estate tax provisions of the 1976 Act, including Section 2010(c), as retroactive, and for that reason violative of the Due Process Clause of the Fifth Amendment (J.S. App. 3a-6a). But the application of that law, however characterized, deprived appellees

of no property, with or without due process. The estate tax return filed by appellees reported a taxable estate of $402,242.10 (J.A. 14). They claimed a unified credit of $34,000, and reported estate tax due of $81,690.56 (*ibid.*). The Commissioner accepted the return as filed, except that he reduced the unified credit from $34,000 to $28,000, as he was required to do by Section 2010(c). He accordingly assessed a deficiency of $6,000, resulting in an estate tax of $87,690.56. If the provisions of the estate tax as it stood in September 1976 had been applied to the same taxable estate, however, the estate tax would have been $88,345.72. See 26 U.S.C. (1970 ed.) 2001. As appellees concede, therefore, "[t]he Tax Reform Act [of 1976] reduced the decedent's estate tax by $655.16" (Mot. to Dis. 6). This diminution of tax liability can hardly be said to have been "so arbitrary and capricious as to render [the law] unconstitutional," in the words of the district court (J.S. App. 6a), or in any fashion to have deprived the estate of property.

C. The District Court Mischaracterized Section 2010(c) As Retroactive Legislation

Contrary to the district court's statement (J.S. App. 3a), Section 2010(c) as applied to appellees does not constitute "retroactive" legislation, and the court thus proceeded from an erroneous premise in holding it unconstitutional. When the decedent made his gifts in September 1976, he received the benefit of the then-existing $30,000 specific exemption for gift tax purposes. The Tax Reform Act of 1976 was signed by the President one week later, and thus became law more than two years before Mr. Hirschi

died. When he died, his estate received the benefit of the then-existing unified credit. It is true that the unified credit was reduced by virtue of his already having employed the gift tax specific exemption, which was one of the two items for which the unified credit was a substitute. But his estate derived considerably more value from the reduced credit of $28,000 than it would have derived from the $60,000 estate tax exemption that existed when he made his gifts.[9] In any event, this Court has regularly held that an estate tax provision that is effective at the date of death "does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States* v. *Jacobs*, 306 U.S. 363, 367 (1939) (footnote omitted). Accord, *United States* v. *Manufacturers National Bank*, 363 U.S. 194, 200 (1960).[10]

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[9] For an estate subject (as was the Hirschi estate) to a 34% marginal rate of tax, the $60,000 estate tax exemption in effect prior to 1977 would have reduced the estate tax otherwise due by $20,400. Under the Tax Reform Act of 1976, by contrast, the unified credit provided to the Hirschi estate reduced the estate tax due by $28,000.

[10] In *United States* v. *Jacobs*, the decedent had paid for property and had it conveyed to himself and his wife as joint tenants in 1909, seven years before the estate tax was first enacted in 1916 (306 U.S. at 364). He died after the Revenue Act of 1924 required that jointly held property be included in the gross estate of the decedent who had furnished the consideration for the transfer. The Court noted that the estate tax "was not levied on the 1909 transfer," but on the testamentary transfer that occurred after the estate tax was amended in 1924 (306 U.S. at 366). The Court accordingly held that the amendment "was not retroactive" (*ibid.*). In *United States*

Indeed, the application of the estate tax has regularly depended upon facts and conditions that may have come into being prior to the enactment of the tax. As noted above, the estate tax has never been limited to property owned by the decedent at the time of his death, but has always, in its original form and as amended, included in the decedent's gross estate some property transferred or otherwise acted upon by him at some earlier time. See, *e.g.*, 26 U.S.C. (1970 ed.) 2035 (transfers in contemplation of death); 26 U.S.C. 2036 (transfers with retained life estate); 26 U.S.C. 2037 (transfers taking effect at death); 26 U.S.C. 2038 (revocable transfers). This Court has never held that the estate tax operates "retroactively" simply because that earlier time was

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v. *Manufacturers National Bank*, the decedent in 1936 had divested himself of ownership of a life insurance policy at a time when that would have removed the policy or its proceeds from his gross estate (363 U.S. at 196). The decedent, however, continued to pay the premiums on the policy until he died (*ibid.*). He died in 1954, after the Revenue Act of 1942 made payment of premiums a test for inclusion of life insurance proceeds in a decedent's gross estate. The Court held that the 1942 amendment, having become effective long before the decedent died, "cannot be said to be retroactive in its impact"; the fact that "the policies were purchased and the policy rights were assigned before the [1942 amendment] was enacted," the Court stated, was "not material" (363 U.S. at 200). See also *Fernandez* v. *Wiener*, 326 U.S. 340, 354 (1945) (upholding estate tax amendment requiring that the entire pre-existing community estate in a community property state be included in the gross estate of the spouse first to die); *Gwinn* v. *Commissioner*, 287 U.S. 224 (1932). If none of the cases summarized above involved retroactivity—and the Court uniformly stated that they did not—it is clear that the district court erred in characterizing the application of Section 2010(c) as retroactive here.

a time before the enactment of the estate tax provision dictating how such property or its transfer should be treated for federal estate tax purposes. See, *e.g.*, *Commissioner* v. *Estate of Church*, 335 U.S. 632 (1949); *Fernandez* v. *Wiener*, 326 U.S. 340 (1945); *Helvering* v. *Hallock*, 309 U.S. 106 (1940); *United States* v. *Jacobs*, 306 U.S. 363 (1939); *Gwinn* v. *Commissioner*, 287 U.S. 224 (1932); *United States* v. *Wells*, 283 U.S. 102 (1931).

D. The District Court Erred In Equating Retroactivity With Unconstitutionality

Even if the 1976 Act, with its enactment of Section 2010(c), were thought to have deprived appellees of property, and to have operated "retroactively" by virtue of its look-back feature, its effect was not so harsh or oppressive as to render it unconstitutional under the Due Process Clause. This Court has squarely rejected the idea that retroactivity in an estate tax statute, any more than in an income tax statute, perforce invalidates it. The Court has held that "a tax is not necessarily and certainly arbitrary and therefore invalid because retroactively applied," and has noted that "taxing acts having retroactive features have been upheld in view of the particular circumstances disclosed and considered by the Court." *Milliken* v. *United States*, 283 U.S. 15, 21 (1931). The Court in *Milliken* upheld the application of higher tax rates, imposed by an amended estate tax statute, to a previously-completed gift in contemplation of death, and also held that the gift could be valued for estate tax purposes at the date of death rather than at the time the gift was made.

This case involves a transitional rule designed to prevent taxpayers from manipulating the timing of

their gifts so as to derive a double tax benefit from the shift to a unified credit estate-and-gift tax regime. The decedent, having elected on September 30, 1976, to claim the full $30,000 specific exemption then permitted to him, had no claim to any further exemption on that score. Under the version of the transitional rule adopted by the House Ways and Means Committee, neither he nor his estate would have been entitled to any further exemption, or to its equivalent in the form of an undiminished unified credit, with respect to gifts that he had made at any time after June 6, 1932. See pages 6-7, *supra*. He and his estate gained no greater entitlement by virtue of the Conference Committee's decision to limit the application of the transitional rule to gifts made after September 8, 1976. That decision might be thought to have conferred a windfall upon certain taxpayers who had the good fortune to make gifts before the Conference Committee acted. But the Committee's decision not to extend that windfall to taxpayers who made gifts between September 8, 1976, and January 1, 1977, was plainly not "so harsh and oppressive as to be a denial of due process." *United States* v. *Darusmont*, 449 U.S. 292, 299 (1981). Such line-drawing is an inherent feature of tax legislation. See *United States* v. *Maryland Savings-Share Insurance Corp.*, 400 U.S. 4 (1970).[11]

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[11] Accord, *e.g.*, *Estate of Renick* v. *United States*, 687 F.2d at 374-376 (rejecting due process challenge to Section 2010(c)). Cf. *Reed* v. *United States*, 743 F.2d 481, 485-486 (7th Cir. 1984), cert. denied, No. 84-866 (June 3, 1985) (rejecting due process challenge to retroactive application of 1978 estate tax amendment); *Fein* v. *United States*, 730 F.2d 1211, 1212-1214 (8th Cir. 1984), cert. denied, No. 84-182 (Oct. 1, 1984) (same); *Estate of Ceppi* v. *Commissioner*,

In holding Section 2010(c)'s transitional rule unconstitutional as applied to appellees, the district court (J.S. App. 4a) relied chiefly on *Untermyer* v. *Anderson*, 276 U.S. 440 (1928). As this Court has repeatedly pointed out on the frequent occasions when it has distinguished that decision, however, *Untermyer* involved the retroactive application of the first gift tax statute—a wholly new tax enacted in 1924—to gifts irrevocably completed before its effective date. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. at 299-300 (distinguishing *Untermyer*); *Milliken* v. *United States*, 283 U.S. at 21 (same). Following this Court's lead, the courts of appeals, if not questioning the continuing vitality of *Untermyer*, have uniformly viewed it as applying only to the retroactive application of a wholly new tax.[12] The *Untermyer* decision

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698 F.2d 17, 20-22 (1st Cir.), cert. denied, 462 U.S. 1120 (1983) (same).

[12] See, *e.g.*, *Fein* v. *United States*, 730 F.2d at 1213-1214 ("the modern trend of decisions has uniformly been to limit" *Untermyer* to the "narrow situation" there involved); *Estate of Ceppi* v. *Commissioner*, 698 F.2d at 21 (collecting cases and concluding that, in light of this Court's subsequent decision in *Milliken*, "*Untermyer* at best remains good law only for the proposition that a wholly new gift tax cannot be applied retroactively"); *Westwick* v. *Commissioner*, 636 F.2d 291, 292 (10th Cir. 1980) (limiting *Untermyer* to "wholly new types of taxes"); *Buttke* v. *Commissioner*, 625 F.2d 202, 203 (8th Cir. 1980) (reading *Untermyer* to bar "retroactive application of a wholly new tax"), cert. denied, 450 U.S. 982 (1981); *Sidney* v. *Commissioner*, 273 F.2d 928, 932 (2d Cir. 1960) (Friendly, J.) ("If Untermyer remains authority at all, it is so only for the particular situation of a wholly new type of tax."). See generally Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960); Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935).

has no bearing upon this case, which involves, not only an amendment to an existing tax, but an amendment that was enacted two years before the taxable event—the transfer of property upon the decedent's death—occurred.

E. Congress Provided Ample Advance Notice Of The Transitional Rule That It Enacted, And This Fact Eliminates Any Basis For A Claim Of Objectionable Retroactivity

Even if one were to accept appellees' contention that Section 2010(c) operates retroactively as applied to them, the decedent in this case "had ample advance notice" (*United States* v. *Darusmont*, 449 U.S. at 299) of the proposed change in the tax laws. The House Ways and Means Committee approved its version of the transitional rule on August 6, 1976. The Conference Committee approved on September 8, 1976, the version that was eventually enacted. The bill passed both houses of Congress on September 16, 1976. All these events occurred before the decedent made his gifts on September 28, 1976. The pattern of those gifts—exactly $45,000 to five family members (J.A. 15-18), tailored precisely to consume the specific exemption and the available annual exclusion —raises the irresistible inference that the decedent planned the transaction with tax considerations in mind, if it does not suggest that he had actual notice of the pending congressional action. In any event, the Committee reports provided him with constructive notice of what the effect of claiming the specific exemption was very likely to be. This Court has regularly held that there is no constitutional impediment to making a statute effective, as here, from the date of public notice. *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, No. 83-245 (June 18, 1984), slip

op. 13-14 ("assuming that advance notice of legislative action with retrospective effects is constitutionally compelled, * * * we believe that employers had ample notice" of the contingent liability imposed by an amended pension statute); *United States* v. *Darusmont*, 449 U.S. at 299 (same, amended tax statute); *United States* v. *Hudson*, 299 U.S. 498 (1937).

Especially should this be so where, as here, a provision with retrospective aspects is adopted to prevent a "rush to the door" by persons seeking to circumvent the accomplishment of the purpose of the legislation. See *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, slip op. 10-13.[13] It is well settled that "[t]he retroactive aspects of legislation * * * meet the test of due process * * * simply [upon a] showing that the retroactive application of the legislation is *itself* justified by a rational legislative purpose" (*id.* at 12 (emphasis added)). It was entirely rational for Congress to remove the incentive for taxpayers to seek the double tax benefit of a $30,000 gift tax exemption, plus an undiminished unified credit, by making gifts after September 8, 1976, and before the January 1, 1977, effective date of the new law.

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[13] See also *Purvis* v. *United States*, 501 F.2d 311 (9th Cir. 1974), cert. denied, 420 U.S. 947 (1975) (sustaining application of the interest-equalization tax, designed to stem outflow of investment capital from the United States, retroactively to transactions consummated during the year after introduction of the legislation); *First National Bank* v. *United States*, 420 F.2d 425 (Ct. Cl.), cert. denied, 398 U.S. 950 (1970) (same).

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

ALBERT G. LAUBER, JR.
Assistant to the Solicitor General

MICHAEL L. PAUP
ERNEST J. BROWN
Attorneys

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NO. 84-1944

In The
Supreme Court of the United States
October Term, 1985

UNITED STATES OF AMERICA, ET AL.,
Appellants,

v.

ALVIN HEMME, ET AL.,
Appellees.

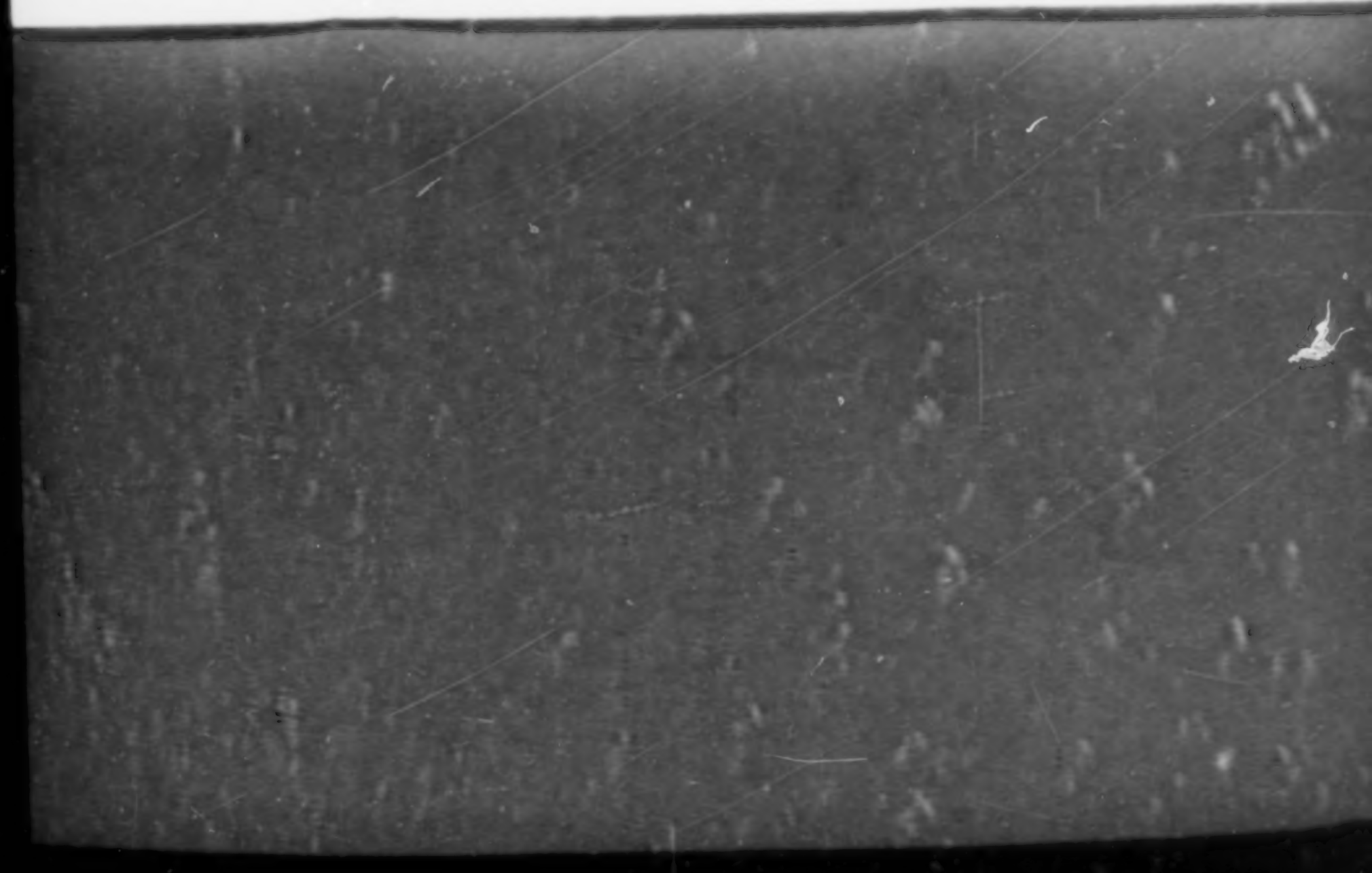
ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

BRIEF FOR APPELLEES ALVIN HEMME, ET AL.

EDWARD F. SUTKOWSKI
DEAN B. RIBLAR
SUTKOWSKI & WASHBURN ASSOC.
500 Jefferson Bank Building
Peoria, Illinois 61602
309/673-4500

DONALD C. RIBLE
916 Broadway
Highland, Illinois 62249
618/654-2364

COCKLE LAW BRIEF PRINTING CO. (800) 225-7427 Ext. 333



QUESTION PRESENTED

Whether 26 U.S.C. 2010(c) as enacted October 4, 1976, properly construed and constitutionally applied, can reduce the unified credit available under 26 U.S.C. 2010(a) to the estate of a decedent who made gifts after September 8, 1976 and before October 4, 1976, claimed a specific exemption under 26 U.S.C. (1970 ed.) 2521 from application of the gift tax in respect of those gifts, and died within three years of the date of the gifts.

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26 U.S.C. 2010(c), PROPERLY CONSTRUED AND CONSTITUTIONALLY APPLIED, CANNOT REDUCE THE UNIFIED CREDIT AVAILABLE UNDER 26 U.S.C. 2010(a) TO THE ESTATE OF A DECEDENT WHO MADE GIFTS AFTER SEPTEMBER 8, 1976 AND BEFORE OCTOBER 4, 1976, CLAIMED A SPECIFIC EXEMPTION UNDER 26 U.S.C. (1970 ed.) 2521 FROM APPLICATION OF THE GIFT TAX IN RESPECT OF THOSE GIFTS, AND DIED WITHIN THREE YEARS OF THE DATE OF THE GIFTS.	15
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NO. 84-1944

In The
Supreme Court of the United States
October Term, 1985

UNITED STATES OF AMERICA, ET AL.,

v.

ALVIN HEMME, ET AL.,

Appellees[1]

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

BRIEF FOR ALVIN HEMME, ET AL.

STATEMENT OF THE CASE

A. The Pre-1977 Statutory Framework

Prior to January 1, 1977, the estate tax and the gift tax had separate rate schedules and exemptions. Gift tax rates were set at three-fourths of the estate tax rate for corresponding brackets.[2] The gift tax was cumulative,

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1 A list of all parties to this proceeding is included in Appellee's motion to dismiss.

2 *Cf.* 26 U.S.C. (1970 ed.) 2001 and 26 U.S.C. (1970 ed.) 2502. *See generally* H.R. Rep. 94-1380, 94th Cong., 2d Sess. 10 (1976).

generally taking into account prior gifts to determine the applicable rate at which a gift would be taxed. 26 U.S.C. (1970 ed.) 2502(a). Although the estate tax base did include certain transfers made "in contemplation of death" (26 U.S.C. (1970 ed.) 2035) and other lifetime transfers (e.g., 26 U.S.C. (1970 ed.) 2036), the estate tax did not cumulate lifetime gifts with the value of a decedent's estate to determine the applicable estate tax rates. 26 U.S.C. (1970 ed.) 2001.

The gift tax permitted each taxpayer a lifetime specific exemption of $30,000 (26 U.S.C. (1970 ed.) 2521), and an annual exclusion of $3,000 per donee per year. 26 U.S.C. (1970 ed.) 2503(b). The specific exemption, at the option of the taxpayer, could be claimed in the full amount of $30,000 in respect of a single gift or be spread over a period of time in such amounts as the taxpayer saw fit. Treas. Reg. § 25.2521-1. The estate tax permitted each estate an exemption of $60,000. 26 U.S.C. (1970 ed.) 2052. The exemption from the estate tax was not reduced by a taxpayer's election to claim the taxpayer's specific exemption from the gift tax.

B. H.R. 14844

On August 2, 1976, the House Ways and Means Committee reported H.R. 14844, the Estate and Gift Tax Reform Act of 1976 (H.R. 14844), a comprehensive revision of the gift and estate taxes. H.R. 14844 was designed in part to reduce the estate and gift tax burden on medium sized estates.[3] The Committee found that since the exist-

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[3] The Federal estate and gift taxes significantly increase the progressivity of our tax system and help prevent excessive concentrations of inherited wealth. In fiscal

(Continued on following page)

ing $60,000 estate tax exemption had been enacted in 1942, the percentage of decedents whose estates were subject to tax had increased from one to eight percent. This increase in the percentage of estates subject to tax resulted from inflation and general economic prosperity. H.R. Rep. 94-1380, *supra*, 15. The Committee's proposal was intended to significantly reduce revenue from the estate tax.[4]

The Committee determined that under prior law there was "a substantial disparity of treatment between the

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(Continued from previous page)

> year 1977, the estate and gift taxes are expected to raise $5.8 billion, all of which comes from the wealthiest 7 percent of the population.
>
> Despite their important role, the Congress has not made a significant change in the estate and gift taxes since 1948. Estate tax revision is long overdue, and this bill undertakes that task.
>
> The purposes of the Estate and Gift Tax Reform Act of 1976 are to reduce the burden of these taxes on medium-sized estates, to eliminate ways by which estate planners can reduce the estate and gift tax burden through special patterns of transferring their property, to reduce the substantial variations in estate and gift tax burdens that now exist for people with the same amount of wealth, to simplify the administration and settlement of estates and to reduce tax incentives for disposition or retention of assets and the resulting distortions in investment decisions.

H.R. Rep. 94-1380, *supra*, 5.

[4] In fiscal 1977, the then-existing estate and gift taxes were expected to raise $5.8 billion, all from the wealthiest seven percent of the population. H.R. Rep. 94-1380, *supra*, 5. The Committee's bill was expected to reduce estate tax liabilities by $15 million in fiscal 1977, $615 million in 1978, $803 million in 1979, $982 million in 1980, and $917 million in 1981. H.R. Rep. 94-1380, *supra*, 3.

taxation of transfers during life and transfers at death", and designed changes to assure that "the tax burden imposed on transfers of the same amount of wealth should be substantially the same whether the transfers are made both during life and at death or made only upon death." H.R. Rep. 94-1380, *supra*, 11. In the Committee's view, the existing gift and estate tax laws provided a decided preference for lifetime transfers since the gift tax rates were set at three-fourths of the estate tax rates at each corresponding rate bracket. A taxpayer could deflect the future appreciation, if any, associated with the property gifted and incur less tax by transferring property during life rather than at death. Further, since lifetime transfers were not taken into account in determining applicable estate tax rates, a taxpayer's estate was subject to tax under a separate rate schedule starting at the lowest rate. Even had the estate and gift tax rates been identical, the separate rate schedules would have provided a preference for making both lifetime and deathtime transfers rather than having the total transfer subject to one tax under a cumulative rate schedule.[5]

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5 Under present law, there is a substantial disparity of treatment between the taxation of transfers during life and transfers at death. In general, there are three factors which provide a decided preference for lifetime transfers. First, the gift tax rates are set at three-fourths of the estate tax rates at each corresponding rate bracket. Second, lifetime transfers are not taken into account for estate tax purposes and the estate remaining at death is subject to tax under a separate rate schedule starting at the lowest rates. Thus, even if the rates were identical, separate rate schedules would provide a preference for making both lifetime and deathtime transfers rather than having the total

(Continued on following page)

H.R. 14844 proposed a single unified rate schedule for gift and estate taxes, with progressive rates based on cumulative lifetime and deathtime transfers. The gift tax payable was to be determined by applying the unified rate schedule to the cumulative lifetime taxable transfers and

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(Continued from previous page)

transfer subject to one tax. Third, the gift taxes paid are not generally taken into account for either transfer tax base. In the case of a gift, the tax base does not include the gift tax but the payment of the tax results in a decrease in the value of the estate retained by the donor. However, if the property were retained until death, the tax base includes the full value of the property, even though a portion is likely to be required to satisfy estate taxes. Thus, even if the applicable transfer tax rates were the same, the net amount transferred to a beneficiary from a given pre-tax amount of property would be greater for a lifetime transfer solely because of the difference in tax bases.

As a matter of equity, your committee believes the tax burden imposed on transfers of the same amount of wealth should be substantially the same whether the transfers are made both during life and at death or made only upon death. As a practical matter, the preferences for lifetime transfers are available only for wealthier individuals who are able to afford lifetime transfers. The preferences for lifetime transfers are not generally available for those of small and moderate wealth since they generally want to retain their property until death to assure financial security during lifetime. Therefore, your committee believes that the preferences for lifetime transfers principally benefit the wealthy and result in eroding the transfer tax base.

Your committee believes that it is desirable to reduce the disparity of treatment between lifetime and deathtime transfers through the adoption of a single unified estate and gift tax rate schedule providing progressive rates based on cumulative lifetime and deathtime transfers.

H.R. Rep. 94-1380, *supra*, 11-12.

then by subtracting the taxes payable on lifetime transfers made in prior periods. The estate tax payable was to be determined by applying the unified rate schedule to the aggregate of cumulative lifetime transfers made after December 31, 1976 and deathtime transfers, and then by subtracting the gift taxes payable on the lifetime transfers. H.R. Rep. 94-1380, *supra*, 13. In unifying the rate schedules for gift and estate taxes, the Committee intended "to preclude having the same lifetime transfers taken into account more than once for transfer purposes" (H.R. Rep. 94-1380, *supra*, 13), and thereby minimize the disparate treatment accorded gratuitous life and death transfers.

The House Ways and Means Committee also proposed a unified credit against the estate and gift taxes in lieu of the $30,000 gift and $60,000 estate exemptions provided under prior law. The Committee noted that the estate tax exemption was not increased for any portion of the gift tax exemption not used against lifetime transfers, and that since the estate tax exemption had been established in 1942, inflation had eroded the exemption to one-third of its original value. H.R. Rep. 94-1380, *supra*, 15. The Committee's proposal was designed to increase the amount of property which could be transferred free of tax, and to correlate tax-free transfers under the estate tax and the gift tax.

The Committee believed that the estate and gift taxes would be more equitable if the specific exemptions were replaced with a unified credit. At a given level of revenue cost, a tax credit would confer more tax savings on small and medium sized estates; specific exemptions tended to

confer more tax savings on larger estates.[6] Since the gift tax exemption was not, as a practical matter, available to individuals who could not afford to make lifetime transfers, a unified credit would more equally tax transfers without regard to whether the transfers were made only at death or made both during lifetime and at death. H.R. Rep. 94-1380, *supra*, 15-16. In general, any portion of the unified credit used against gift tax would reduce the credit available to be used against the estate tax. Even though the unified credit rules were set forth separately under the estate tax provision and under the gift tax provision, the credit was intended to effect a single unified credit for estate and gift tax purposes. H.R. Rep. 94-1380, *supra*, 16.

H.R. 14844 contained a transitional rule which applied to a taxpayer who benefited from the $30,000 specific exemption from gift tax at any time after June 6, 1932.[7] The Committee, in explaining the transitional rule, stated:

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[6] Since the existing estate tax exemption was a deduction in determining the taxable estate, the exemption reduced each estate's tax at the highest applicable tax bracket. Thus, the larger the estate (and the higher the applicable estate tax bracket), the greater the economic benefit of the specific exemption. A tax credit, on the other hand, would be applied as a dollar-for-dollar reduction of the estate tax otherwise due. See H.R. Rep. 94-1380, *supra*, 15.

[7] Section 2010(c) of H.R. 14844 (set forth at H.R. Rep. 94-1380, *supra*, 94) provided:

> ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1977—The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20% of the aggregate amount allowed in respect of the decedent as a specific exemption under § 2521 (as in effect before its repeal by the Estate and Gift Tax Reform Act of 1976).

> As a transitional rule, the unified credit *allowable* is to be reduced by an amount equal to 20 percent of the amount *allowed* as a specific exemption in computing taxable gifts under present law. Thus, in the case where a donor had *benefited* from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit *allowable* would be reduced by $6,000.

H.R. Rep. 94-1380, *supra*, 16 (emphasis added). The Committee equated the phrase "allowed as a specific exemption" with "benefited from the use of the full $30,000 gift tax specific exemption." In view of the unification of the estate and gift taxes proposed by H.R. 14844, a donor would benefit through use of the gift tax exemption only if the gifted assets in respect of which the specific exemption was claimed were not subjected to the unified estate and gift tax in the donor's estate.

C. Conference Report on H.R. 10612, and the Tax Reform Act of 1976

On September 14, 1976 the Conference Committee issued its conference report on the proposed legislation, the Tax Reform Act of 1976 ("Act"). H.R. 10612, the House bill on income tax reform, had not contained revisions to the estate and gift taxes. The Senate had amended H.R. 10612 to include amendments to the estate and gift tax laws. The Conference Committee proposal substantially modified the Senate amendment to the House bill, and adopted many of the provisions contained in H.R. 14844. To the extent that the Conference proposal followed H.R. 14844, "the conferees agree[d] with and incorporate[d] the explanation of those provisions contained in House Re-

port 94-1380 (the Ways and Means Committee Report on H.R. 14844), except as modified in" the conference report. S. Conf. Rep. 94-1236, 94th Cong. 2d Sess. 607 (1976). The Conference Committee's proposal, and the Act as adopted, have been described as flawed, both technically and substantive, in many respects.[8]

H.R. 14844 had proposed a unified credit in lieu of the gift tax and estate tax specific exemptions. The Senate amendment had proposed a credit in lieu of the estate tax specific exemption, but had retained the then existing specific exemption from gift tax. S. Conf. Rep. 94-1236, *supra* 607-8; S. Rep. 94-938, 94th Cong. 2d Sess. (Part 2), 94th Cong. 13 (1976). The Conference agreement generally

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[8] The estate and gift tax amendments focus upon a number of areas which have been of particular concern and which have enjoyed extensive study over the years. Considering this background of concern and study, it is rather surprising that the amendments are so flawed, technically and substantively, in so many respects. The basic reason for this appears to lie in the relatively brief time allowed by Congress for the development of the reform amendments. Too little time was allowed for consideration of policy questions subsidiary to otherwise sound general policy decisions. Disagreements as to certain policy judgments appear to have been precipitously compromised, resulting in distortions of principle. And, too little time was allowed for the effective drafting of statutory provisions which, in any event, would be somewhat complex, but which, in fact, are unusually tortuous and obscure. The upshot is a piece of legislation, presently in effect, which profoundly affects planning for the distribution of wealth, but which is frequently unclear and conceptually inconsistent and which is likely to be modified in a number of substantial respects in the years to come.

J. McCord, *1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary*, 1-2 (1977).

followed H.R. 14844 with respect to unification of the estate and gift tax rate schedules. Following H.R. 14844, the Conference agreement provided for a unified credit in lieu of the gift and estate tax specific exemptions. In apparent deference to the Senate amendment (which would have retained the $30,000 specific exemption from the gift tax), the conferees agreed that the unified credit was not to be reduced for any amount allowed as a specific exemption for gifts made prior to September 9, 1976.

Section 2010(c) (26 U.S.C. 2010(c)), as reported by the Conference Committee and adopted by the Act, provides the following transitional rule:[9]

> ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1976—the amount of the credit *allowable* under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount *allowed* as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976. (Emphasis added.)

The transitional rule was apparently designed to limit the benefit of the new unified credit to taxpayers who ex-

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9 The Conference Committee, in describing the transitional rule, stated:

> The unified credit *allowable* is to be reduced by an amount equal to 20 per cent of the amount *allowed* as a specific exemption under present law for gifts made after September 8, 1976, and before January 1, 1977. However, the unified credit is not to be reduced for any amount *allowed* as a specific exemption for gifts made prior to September 9, 1976.

S. Conf. Rep. 94-1236, *supra*, 607-8 (emphasis added).

ploited the specific exemption available for gifts made before January 1, 1977.[10]

D. Facts and Proceedings in this Case

On September 28, 1976 Charles W. Hirschi made gifts to five individuals totalling $45,000. J.A. 6. In a gift tax return filed on September 30, 1976, Mr. Hirschi claimed a specific exemption in the amount of $30,000. J.A. 9. The exemption claimed by Mr. Hirschi served to exempt $30,000 of the gifts from gift tax pursuant to 26 U.S.C. (1970 ed.) 2521. The remaining $15,000 of gifts were ex-

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10 The House Bill would have required reduction of the amount of the unified credit allowed to a taxpayer by an amount equal to 20 percent of any amount claimed by the taxpayer as a specific exemption under Section 2521 of prior law. This provision was based upon the rationale that if a taxpayer had made gifts before the effective date of the new law and had already benefited from the use of the specific exemption, it is appropriate that this prior benefit be taken into account. See H. Rep. at 16.

As ultimately enacted, the reduction of the unified credit for use of the specific exemption is limited to gifts made on and after September 9, 1976, the date the final version of the Act was agreed to by the House and Senate Conferees. It is designed to limit the benefit of the new unified credit in the case of taxpayers who, in anticipation of the new law, may have sought to exploit the specific exemption available for gifts made before January 1, 1977, the effective date of the new law. As enacted, Sections 2010(c) (estate tax) and 2505(c) (gift tax) provide that the amount of the unified credit otherwise allowable to any taxpayer be reduced by 20 percent of the amount allowed as a specific exemption under Section 2521 for gifts made by the taxpayer after September 8, 1976.

J. McCord, *1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary*, 26 (1977).

cluded from the gift tax by virtue of the $3,000 per donee annual exclusion of 26 U.S.C. (1970 ed.) 2503(b).

Mr. Hirschi died on November 9, 1978, two years, one month and eight days after making the lifetime gifts. His estate filed a federal estate return. The estate included $30,000 of the gifts made on September 28, 1976 and within three years of Mr. Hirschi's death, as required by 26 U.S.C. 2035. In calculating the estate tax due, Mr. Hirschi's estate claimed a unified credit against estate tax in the amount of $34,000, the maximum unified credit then available under 26 U.S.C. 2010(a) without reduction. In auditing the estate tax return, the Internal Revenue Service reduced the $34,000 unified credit claimed by Mr. Hirschi's estate by $6,000 on the authority of 26 U.S.C. 2010(c), given Mr. Hirschi's gifts in the amount of $30,000 during the period from September 8, 1978 to December 31, 1976. J.A. 6. The Internal Revenue Service then concluded that a deficiency existed in the estate tax paid in the amount of $6,000. J.A. 6. In July of 1982, Mr. Hirschi's estate paid the additional tax of $6,000 (J.A. 7), and thereafter instituted the action with respect to which this appeal was taken.

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SUMMARY OF ARGUMENT

The estate and gift tax provisions of the Tax Reform Act of 1976 ("Act") were designed to reduce the estate and gift tax burden on medium-sized estates and, by unifying the estate and gift taxes, to eliminate disparate treatment between the taxation of gratuitous transfers

during life and at death. The Act replaced the estate and gift tax exemptions with a unified credit against both estate and gift taxes. Since the Act was adopted on October 4, 1976 and was to be generally effective January 1, 1977, Congress was apparently concerned that a taxpayer would, after learning of the Act, benefit from the $30,000 specific exemption from the gift tax during the transition period, and also be able to use the full unified credit available under the Act. Congress sought to preclude a taxpayer from benefiting under the specific exemption during the transition period and the full unified credit after the effective date of the Act by adopting the transitional rule in 26 U.S.C. 2010(c).

The Government urges that since Mr. Hirschi made gifts of $30,000 on September 28, 1976 and claimed his $30,000 specific exemption from gift tax against such gifts, Mr. Hirschi's estate must reduce the available unified credit by $6,000 even though his estate included and paid tax on the $30,000 of gifted assets in respect of which the specific exemption was claimed. The harsh result urged by the Government is not "consistent with either the letter or intent of the relevant provisions of the [Internal Revenue] Code." *Gladney v. Commissioner*, 54 U.S.L.W. 3268 (October 22, 1985) (O'Connor, J., dissenting from denial of certiorari). Section 2010(c) provides for a reduction of the unified credit only where the specific exemption has been allowed with respect to a gift during the transitional period. Congress intended that the unified credit be reduced only where the donor had benefited through use of the donor's specific exemption. Although Mr. Hirschi claimed a $30,000 specific exemption in respect of the September 28, 1976 gifts, the exemption was

not finally allowed under the unified estate and gift tax structure. When the gifts were included and taxed in Mr. Hirschi's estate, Mr. Hirschi's claimed $30,000 specific exemption was effectively disallowed. Accordingly, neither Mr. Hirschi nor his estate received a benefit from the exemption within the meaning of the transitional rule. Section 2010(c), construed in harmony with the scheme and general purposes of the Act, should not be applied to reduce the unified credit available to Mr. Hirschi's estate.

As applied to Mr. Hirschi's estate, Section 2010(c) imposes a retroactive penalty tax upon Mr. Hirschi's exercise of his statutory right to claim a specific exemption from tax, even though Mr. Hirschi ultimately received no benefit from his claim to his specific exemption. Mr. Hirschi made the gifts and claimed his specific exemption prior to October 4, 1976, the adoption date of the Act. At the time Mr. Hirschi exercised his right to claim his specific exemption, his claim to the specific exemption may have decreased, but could not have increased, the estate taxes ultimately payable by his estate. Since Mr. Hirschi's gifts were included and taxed in his estate, application of Section 2010(c) to reduce the unified credit available to his estate is unnecessary to prevent Mr. Hirschi and his estate from receiving a double tax benefit. Section 2010(c), as applied to Mr. Hirschi's estate, arbitrarily ignores Mr. Hirshi's right, in effect when Mr. Hirschi made the gifts, to make up to $30,000 in gifts, claim an exemption from gift tax, and suffer no possible increase in estate tax by virtue of the claimed exemption.

ARGUMENT

26 U.S.C. 2010(c), PROPERLY CONSTRUED AND CONSTITUTIONALLY APPLIED, CANNOT REDUCE THE UNIFIED CREDIT AVAILABLE UNDER 26 U.S.C. 2010(a) TO THE ESTATE OF A DECEDENT WHO MADE GIFTS AFTER SEPTEMBER 8, 1976 AND BEFORE OCTOBER 4, 1976, CLAIMED A SPECIFIC EXEMPTION UNDER 26 U.S.C. (1970 ed.) 2521 FROM APPLICATION OF THE GIFT TAX IN RESPECT OF THOSE GIFTS, AND DIED WITHIN THREE YEARS OF THE DATE OF THE GIFTS.

A. The Transitional Rule Incorporated In 26 U.S.C. 2010(c), Properly Construed, Does Not Reduce the Unified Credit Otherwise Allowable to Mr. Hirschi's Estate.

This Court typically "will not pass on the constitutionality of an Act of Congress if a construction of the statute is fairly possible by which the question may be avoided." *United States v. Clark*, 445 U.S. 23, 27 (1980). Since both a constitutional issue and an issue of statutory construction were raised before the district court, this Court is not foreclosed from considering the statutory question merely because the district court failed to address it. *Clark*, *supra* at 27.

"The starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J. concurring). The Act introduced a unified credit to be applied against both the gift tax and the estate tax. 26 U.S.C. 2010 and 2505. Section 2010(c) of the Code, as contained in the Act, provided that the unified credit:

> * * * shall be reduced by an amount equal to 20 percent of the aggregate amount *allowed* as a specific exemption under § 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976. (Emphasis added.)

Although Mr. Hirschi, in his gift tax return filed on September 30, 1976, claimed his $30,000 specific exemption with respect to his gifts, his specific exemption was, in effect, never allowed. Upon Mr. Hirschi's death within three years of the gifts, the gifts were included and taxed in Mr. Hirschi's estate. The transitional rule reducing the unified credit in certain instances was intended to apply "where a donor had *benefited* from the use of the * * * gift tax specific exemption." H.R. Rep. 94-1380 *supra*, 16 (emphasis added). Mr. Hirschi's claim of the $30,000 specific exemption would have benefited Mr. Hirschi only if he had survived three years from the date of the gift and the gifts were not included in his estate. Since Mr. Hirschi died within three years of the date of the gifts, the gifts were included in his estate, and subjected to estate taxes.[11]

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[11] Appellees acknowledge that if Hirschi had survived three years after September 28, 1976, and if the Internal Revenue Service had not disallowed Hirschi's claimed exemption within three years of the filing of Hirschi's gift tax return, the unified credit otherwise allowable to Hirschi's estate under 26 U.S.C. § 2010(a) would have been reduced by $6,000 pursuant to 26 U.S.C. § 2010(c). Thus, the taxpayers who would benefit from a ruling against the Government is a closed class of taxpayers who made gifts between September 8, 1976 and October 4, 1976, the date of the enactment of the Act, claimed all or a portion of the $30,000 specific exemption in respect of those gifts, and died within three years of making those gifts.

The Government's contention is that Mr. Hirschi's election to claim his $30,000 specific exemption in respect of the September 28, 1976 gifts forces a reduction of his unified credit under 26 U.S.C. 2010(c).[12] To the contrary, the statute clearly provides for the unified credit to be reduced "by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under § 2521". 26 U.S.C. 2010(c). In construing tax statutes, "it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used * * *. In case of doubt they are to be construed most strongly against the Government, and in favor of the citizen." *Gould v. Gould*, 245 U.S. 151, 153 (1917).

The fact that Mr. Hirschi claimed his $30,000 specific exemption does not meet the statutory threshold for reduction of the unified credit. To reduce the amount of unified credit, the specific exemption must have been not only claimed, but allowed. While the parties stipulated that Mr. Hirschi had elected to apply the specific exemption of $30,000 (J.A. 5), the record does not reflect that the specific exemption was allowed by the Internal Revenue Service. Moreover, Mr. Hirschi's claimed specific exemption was not finally allowed as of Hirschi's death

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[12] The parties stipulated in the district court that:

> The sole issue to be decided herein is whether the decedent's *election* to apply the $30,000 specific exemption against the taxable gifts made on September 28, 1976 results in a $6,000 reduction of the unified credit pursuant to Internal Revenue Code § 2010(c), where the gifts were included in the decendent's gross estate, for estate tax purposes, pursuant to Internal Revenue Code, Section 2035.

J.A. 7 (emphasis added).

on November 9, 1978.[13] Mr. Hirschi's claim to his $30,000 specific exemption was effectively disallowed by the inclusion of the $30,000 gifted assets in his estate for Federal estate tax purposes. Under our federal tax system, "'[a]llowed' connotes a grant."[14] *Virginian Hotel Corp. v. Helvering*, 319 U.S. 523, 527 (1942). Since Mr. Hirschi's gifts were included and taxed in his estate, Mr. Hirschi was granted no benefit by virtue of his claim to a specific exemption, and his claim was never "allowed".

This Court has noted that "[t]he true meaning of a single section of this statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history

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13 The Service could have disallowed Mr. Hirschi's claimed specific exemption and assessed a deficiency with respect to Mr. Hirschi's gift tax return at any time within three years after the return was filed, or until more than ten months after Mr. Hirschi's death. 26 U.S.C. 6501.

14 The Court in *Virginian Hotel Corp.* proceeded to discuss that with respect to income taxes:

> Under our federal tax system there is no machinery for formal allowances of deductions from gross income. Deductions stand if the Commissioner takes no steps to challenge them. Income tax returns entail numerous deductions. If the deductions are not challenged, they certainly are "allowed," since tax liability is then determined on the basis of the returns. Apart from contested cases, it is indeed the only way in which deductions are "allowed."

319 U.S. at 527. Unlike the income tax system, the scheme of the unified gift and estate taxes automatically disallows any claim to a specific exemption from gift tax when the gifted assets are included in and taxed in the donor's estate.

of the income tax legislation of which it is an integral part." *Commissioner v. Engle*, 464 U.S. 206, 78 L.Ed.2d 420, 433 (1983). In construing 26 U.S.C. 2010(c), this Court should apply "that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested." *Commissioner v. Engle*, supra, 78 L.Ed.2d at 429 (1983), quoting *NLRB v. Lion Oil Co.*, 352 U.S. 282, 297 (1957) (Frankfurter, J., concurring in part and dissenting in part). Interpretations of the statute "which would produce absurd results are to avoided if alternative interpretations consistent with the legislative purpose are available". *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982). Tax statutes "should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences". *Farmers Loan & Trust Company v. Minnesota*, 280 U.S. 204, 212 (1930).

The Government interprets 26 U.S.C. 2010(c) as a punitive measure designed to reduce the unified credit available to any donor claiming a specific exemption with respect to gifts made between September 8, 1976 and October 4, 1976, even if the donor did not benefit from the claimed exemption. If Mr. Hirschi had made the gifts and claimed his specific exemption prior to September 8, 1976, his gifts and claim of exemption would not have reduced the old estate tax exemption or the new unified credit,

whichever was in effect as the time of his death.[15] If Mr. Hirschi had waited to make his gifts until after December 31, 1976, the unified credit allowable to Mr. Hirschi's estate would not have been reduced by virtue of Mr. Hirschi's lifetime transfers.[16] The Act's legislative history does not suggest that Congress intended to alter this established policy by punishing donors who attempted to gift property during their lifetime. Rather, Congress intended to assure that "the tax burden imposed on transfers of the same amount of wealth should be the same whether the transfers are made both during life and at death or made only upon death." H.R. Rep. 94-1380, *supra*, 11.

Congress further intended "to preclude having the same lifetime transfers taken into account more than once

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[15] Under the tax statutes as in effect prior to the Act, a donor was entitled to a specific exemption of $30,000 from the gift tax, and the donor's estate would be entitled to an unreduced exemption of $60,000 from the estate tax. A specific exemption from the gift would not have reduced or impaired his estate's right to exempt $60,000 from the estate tax. 26 U.S.C. (1970 ed.) 2052. Even under the Government's interpretation of 26 U.S.C. 2010(c), the unified credit would not be reduced in respect of gifts made prior to September 9, 1976.

[16] If Mr. Hirschi had made the gifts after December 31, 1976 and died on November 8, 1978, the gifts would have been included in Mr. Hirschi's estate. 26 U.S.C. 2035. Although estate taxes owed by the estate would have, in effect, included tax attributable to the value of the lifetime transfers (see 26 U.S.C. 2001(b)), the amount of unified credit available to Mr. Hirschi's estate would not have been reduced by virtue of Mr. Hirschi's having claimed a portion of the unified credit in respect of the lifetime gifts (26 U.S.C. 2010). "[T]he credit is in effect a single unified credit for estate and gift tax purposes." H.R. Rep. 94-1380, *supra*, 16.

for transfer tax purposes". H.R. Rep. 94-1380, *supra*, 13. The Government's interpretation of § 2010(c) would, in effect, take Mr. Hirschi's gifts into account for both the gift tax and the estate tax. Mr. Hirschi's gifts were included and taxed in his estate. The only rationale for applying Section 2010(c) to reduce the unified credit available to Mr. Hirschi's estate is that Mr. Hirschi benefited from his claim to the specific exemption in respect of the gifts. If Mr. Hirschi benefited from his claim to the exemption, then the gifted assets are taken into account for gift tax purposes as well as estate tax purposes, contrary to Congress' intent that lifetime transfers be subjected to only one transfer tax.

The Government relies heavily on the Court of Claims' decision in *Estate of Renick v. United States*, 687 F.2d 371 (Ct.Cl. 1982). In *Renick*, the taxpayer made a gift of $100,000 two months after the enactment of Section 2010(c) rather than on September 28, 1976, the date of Mr. Hirschi's gifts which was made more than one week before October 4, 1976, the date the President signed the Act. The Court of Claims, in construing the statute, mischaracterized the most material provision of Section 2010(c).[17] In seeking to ascribe the "plain meaning" to Section 2010(c) the Court of Claims concluded that:

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[17] The Government had itself misquoted 26 U.S.C. Section 2010(c) in its Brief before the Court of Claims:

> The credit was to be phased in over a five-year period, beginning at $30,000 for the calendar year 1977, and rising to $47,000 for the calendar year 1981 and years thereafter. However, the total allowable credit was to be "reduced by an amount equal to 20 percent of the aggregate amount *allowable* as a specific exemption" with respect to gifts made after September 8, 1976, and before January 1, 1977. Section 2010(c).

Brief for the United States in Support of its Cross Motion on the Pleadings and in Opposition to Plaintiffs' Motion for Judgment on the Pleadings at 6-7 (Emphasis added), *Renick*, *supra*.

> The plain language and legislative design of § 2010(c) show that Congress intended the reduction to the unified credit to occur in all cases where gifts were made during the transition period and the specific gift tax exemption of $30,000 *allowable* under prior law, or any part thereof, was taken by the donors. The court cannot imply an exception to the statute merely because it would be more reasonable or more equitable to do so. Any such change or modification of 2010(c) must be left to Congress. (687 F.2d at 376 (emphasis added)).

The plain language of Section 2010(c), of course, provides for the unified credit to be reduced by an amount equal to 20 percent of the "aggregate amount *allowed* as a specific exemption under section 2521." Section 2010(c) (emphasis added).

The Court of Claims in *Renick*, following a cursory examination of the Act and its legislative history, erroneously concluded that at the time the decedent made the gift, "it appeared that he would benefit from the $30,000 exclusion". 687 F.2d at 377. The Act's scheme and general purpose were designed to unify the estate and gift taxes. Whether or not a donor ultimately benefited by virtue of a claimed specific exemption could not be determined until the earlier of the donor's death or the passage of three years from the date of the gift. If the donor made a gift which was ultimately included in the donor's taxable estate, the donor would receive no benefit from the claimed specific exemption under the unified estate and gift tax system. In holding that the tentative receipt of a benefit is equal to the actual receipt of the benefit, the Court of Claims ignored the scheme and general purposes that Congress manifested in adopting the Act.

The Government contends that the situation in which Appellees find themselves is not "inequitable" (Government's Brief, p. 16), or even if "inequitable", that such "inequity stems, not from the Internal Revenue Code, but from the fact of human mortality." (Government's Brief p. 17). The opposite is true. If Mr. Hirschi had made the gifts and not claimed his specific exemption but paid the $2,250 in gift tax that would then have been due, his estate would have had credited against the estate tax the $2,250 in gift tax paid (26 U.S.C. 2012) and would have enjoyed the full $34,000 in credit if he died within three years from the date of his gift. Thus, under the Government's interpretation, Mr. Hirschi caused his estate to pay more tax than his estate would have paid had he not claimed his $30,000 specific exemption. But, in unifying the estate and gift taxes, Congress intended to impose the same overall taxes whether the transfers were made both during life and at death or only at death.

The Government apparently urges that the Committee report which read as follows with respect to the transitional rule:

> As a transitional rule, the unified credit *allowable* is to be reduced by an amount equal to 20 percent of the amount *allowed* as a specitic exemption in computing taxable gifts under present law. Thus, in the case where a donor had *benefited* from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit *allowable* would be reduced by $6,000.

(H.R. Rep. 94-1380, (emphasis added)), should have read as follows:

> As a transitional rule, the unified credit *allowable* is to be reduced by an amount equal to 20 percent of the

amount *allowable* as a specific exemption in computing taxable gifts under present law. Thus, in the case where a donor had *claimed* the use of the full $30,000 gift tax specific exemption under present law, the maximum credit *allowable* would be reduced by $6,000 *even if the property which was the subject of the claimed $30,000 gift tax specific exemption is subsequently included in the donor's estate by reason of the application of Code Section 2035 or other applicable section.* (Emphasis added.)

The treatment accorded split gifts by Congress under the Act further illustrates that the harsh result urged by the Government is contrary to the intent of the Act. Under the split gift provision of the Act, the spouse of a donor may treat the gift as though the donor had given away half of the property and the donor's spouse had given away the other half. 26 U.S.C. 2513. This optional gift splitting privilege effectively doubles the gift tax exclusions and credits and thus permits the gift to be taxed in a lower bracket. If upon the death of the actual donor the property transferred is included in the actual donor's estate, a question arises as to the treatment of the specific exemption under prior law or unified credit claimed by the surviving spouse in connection with the split gift. This question was specifically disposed of under the Act in a fashion not to penalize the estate of either the actual donor or the consenting spouse.[18]

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[18] The Act did not substantially change prior law. If a gift made by a decedent is includible in the decedent's gross estate, the full amount of the gift is included, even though at the time the gift was made the decedent's spouse consented to treat the gift as made one-half by each spouse. Thus, 26 U.S.C. 2513 is viewed as providing a method for

(Continued on following page)

For purposes of computing the gift tax payable with respect to gifts subsequently made by the consenting spouse, 26 U.S.C. 2503 mandates the forfeiture of such credit. Thus, under 26 U.S.C. 2505(a), the consenting spouse's unified gift tax credit for future gifts will be reduced by any credit "allowable" against prior gifts, even including split gifts. 26 U.S.C. § 2505(a). The House explanation of 26 U.S.C. 2001(d) specifies the same result:

(Continued from previous page)

computing the gift tax, and has no bearing on whether a gift actually made by the decedent during the decedent's life may be included in the decedent's gross estate. See Rev. Rul. 54-246, 1954-1 C.B. 179.

Under prior law, if the consenting spouse claimed the $30,000 specific exemption against the one-half portion of a split gift attributed to the consenting spouse, and if such exemption was allowed, the amount of the exemption thus claimed and allowed would not be restored for any future gift made by the consenting spouse, even though the split gift was fully included in the estate of the deceased spouse. *Ingalls v. Commissioner*, 40 T.C. 751 (1963), *aff'd*, 336 F.2d 874 (4th Cir. 1964).

26 U.S.C. 2001(d), quoted in the following paragraph, mandates this same treatment under the Act. Inclusion of the full value of the split gift in the estate of the actual donor is assumed and the allowance of the gift tax liability imposed upon the one-half portion attributable to the consenting spouse as a tax payable credit against the tentative estate tax of the decedent-donor is provided.

(d) ADJUSTMENT FOR GIFT TAX PAID BY SPOUSE—For purposes of subsection (b)(2), if—

(1) the decedent was the donor of any gift one-half of which was considered under section 2513 as made by the decedent's spouse, and

(2) The amount of such gift is includible in the gross estate of the decedent, any tax payable by the spouse under chapter 12 on such gift (as determined under section 2012(d)) shall be treated as a tax payable with respect to a gift made by the decedent.

> In addition, the gift tax paid by a spouse is to be a subtraction, or offset, in computing the estate tax imposed where the transfer subject to the tax is included in the decedent's gross estate and was considered to have been a transfer made in part by the surviving spouse under the gift-splitting provisions of present law. The effect of this treatment is to reverse the consequences of having treated the surviving spouse as the donor of one-half of a gift made to a third party for gift tax purposes where the property transferred is subsequently included in the decedent's gross estate. *However, there is to be no restoration of any portion of the unified credit used against gift taxes paid by the surviving spouse. (This treatment is similar to court decisions reached under present law which do not permit restoration of any portion of the gift tax exemption used with respect to a transfer which is later included in the other spouse's estate because it was made in contemplation of death.)*

H.R. Rep. 94-1380, *supra*, 13. (emphasis added). In contrast to the Committee comments relating to Section 2010(c), the Committee expressly provided that the unified credit was not to be restored in this split gift situation.

Although no portion of the consenting spouse's unified gift tax credit is thereafter restored, the adverse effect resulting from such spouse's consent to split-gift treatment is corrected by means of an estate tax computation. In computing the tentative estate tax of a consenting spouse, there is excluded from the amount of the consenting spouse's adjusted taxable gifts the amount of the gifts that were included in the donor spouse's estate.[19] Moreover, in computing the final estate tax, the gift tax

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[19] *See* 26 U.S.C. 2001(b) and (c).

paid by the consenting spouse is not allowed as part of the gift tax offset on the consenting spouse's estate tax return to the extent that the offset had been used on the donor spouse's estate tax return by reason of the application of 26 U.S.C. 2001(d). Thus, if the credit is forfeited, the amount of the gift against which such credit was applied is removed from the estate of the consenting spouse.

The Government contends for the contrary with respect to Mr. Hirschi: Mr. Hirschi's unified credit must be reduced, *and* the gifts causing the reduction of his credit must be included in his estate.

B. The Transitional Rule, if Applied to Reduce the Unified Credit Otherwise Allowable to Mr. Hirschi's Estate, is a Retroactive Tax Imposed Upon Mr. Hirschi's Exercise of His Right to Claim a Specific Exemption, and is Arbitrary, Capricious and Constitutionally Invalid.

Consistent with the holding of the district court, 26 U.S.C. 2010(c) as applied to Mr. Hirschi and his estate is unconstitutionally arbitrary and capricious and an unfair trap for the wary.[20] Mr. Hirschi made gifts on September 28, 1976, and claimed his $30,000 specific exemption by timely filing his gift tax return reflecting the gifts. At the time Mr. Hirschi claimed the specific exemption, his

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[20] Appellants assert that "Contrary to the District Court's statement (J.S. App. 3a), Section 2010(c) as applied to Appellees does not constitute 'retroactive' legislation . . . ." (Appellants' Brief, p. 18.) In fact, the District Court held as follows:

> Accordingly, we hold that the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional. (J.S. App. p. 6a.)

claim to the specific exemption could not have increased the amount of tax ultimately payable by his estate. Given his death two years, one month and eight days later, his September, 1976 gifts became subject to the estate tax and his otherwise available $34,000 unified credit was reduced by 20% of the $30,000 specific exemption claimed. Thus, the amount of his estate tax was increased by $6,000, even though he received no benefit from his claim to his specific exemption from gift tax. Section 2010(c), if applied to Mr. Hirschi's estate, imposes a tax upon Mr. Hirschi's exercise of his right to claim the specific exemption. No rational legislative purpose supports the retroactive imposition of a tax upon a taxpayer's claim to his statutorily allowed specific exemption.

"The touchstone of due process is protection of the individual against arbitrary action of government***." *Wolff v. McDonnell*, 418 U.S. 539, 558 (1974). The Due Process clause of the Fifth Amendment "bars Congress from enactments that shock the sense of fair play." *Galvan v. Press*, 347 U.S. 522, 530 (1953). This Court has recognized that due process applies to prevent Congress, through a seeming exercise of the taxing power, from arbitrarily confiscating property through gross and patently inequitable classifications.[21] *Brushaber v. Union*

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21 So far as the due process clause of the Fifth Amendment is relied upon, it suffices to say that there is no basis for such reliance since it is equally well settled that such clause is not a limitation upon the taxing power conferred upon Congress by the Constitution; in other words, that the Constitution does not conflict with itself by conferring upon the one hand a taxing power and

(Continued on following page)

Pacific R.R. Co., 240 U.S. 1 (1916). "[A] statute purporting to tax may be so arbitrary and capricious as to amount to confiscation and offend the 5th Amendment." *Nichols v. Coolidge*, 274 U.S. 531, 542 (1927). In *Blodgett v. Holden*, 275 U.S. 142, (1927), modified 276 U.S. 594 (1928), this Court held the Revenue Act of 1924, insofar as it undertook to impose a tax on gifts made prior to the effective date of the act, was arbitrary and invalid under the Due Process clause because:

> [i]t seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing.

275 U.S. at 147. Further, in *Untermyer v. Anderson*, 276 U.S. 440 (1928), this Court held that the Revenue Act of 1924, even as applied to gifts made while the act was pending before Congress, was arbitrary and invalid:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage

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(Continued from previous page)

> taking the same power away on the other by the limitations of the due process clause. And no change in the situation here would arise even if it be conceded, as we think it must be, that this doctrine would have no application in a case where although there was a seeming exercise of the taxing power, the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the Fifth Amendment, or, what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality inevitably lead to the same conclusion.

Brushaber v. Union Pac. R.R. Co., 240 U.S. 1, 24-5 (1916) (citations omitted).

> of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation and practical application of the statute, and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not expressed until final action thereon has been taken.

276 U.S. at 445-46.[22] "Since, in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process." *Welch v. Henry*, 305 U.S. 134, 147 (1938).

Statutory classifications are generally valid if they bear a rational relation to a legitimate governmental purpose. *See e.g. Harris v. McRae*, 448 U.S. 297, 322 (1980). Congress has broad latitude in creating classifications and distinctions in tax statutes. *Regan v. Taxation with Representation*, 461 U.S. 540, 547 (1983). "Traditionally classification has been a device for fitting tax programs

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[22] In *Untermyer v. Anderson*, 276 U.S. 440 (1928), this Court held that the Revenue Act of 1924, 43 Stat. 313-15, as applied to gifts made before the date of enactment was unconstitutional because it was so unfair and arbitrary that it violated the due process clause of the Fifth Amendment. The holding in *Untermyer* has been limited by this Court to a "new tax" rather than to additions to an existing tax, *United States v. Darusmont*, 449 U.S. 292 (1981).

to local needs and usages in order to achieve an equitable distribution of the tax burden." *Regan, supra,* 547, citing *Madden v. Kentucky,* 309 U.S. 83 (1940). The test of validity of tax statutes in respect of due process is whether the means adopted is appropriate to the end. "[I]f the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive, when viewed in light of the expected benefit, or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guaranty of due process is infringed." *Helvering v. City Bank Farmers Trust Co.,* 296 U.S. 85, 90 (1935).

The only purpose suggested by the Government for the transitional rule contained in Section 2010(c) is to prevent a taxpayer and his estate who had claimed the specific exemption under 26 U.S.C. (1970 ed.) 2521 from deriving a double tax benefit from an unreduced unified credit under 26 U.S.C. 2010, in addition to the benefit afforded by the taxpayer's use of the taxpayer's specific exemption. Government's Brief 12. As applied to Mr. Hirschi's estate the transitional rule is overbroad, since inclusion of Mr. Hirschi's gifts in his estate prevented any double tax benefit. To the extent Section 2010(c) applies to reduce the unified credit otherwise allowable to Mr. Hirschi's estate, Section 2010(c) imposes a retroactive penalty tax upon Mr. Hirschi's estate because Mr. Hirschi exercised his right to claim a specific exemption even though Mr. Hirschi ultimately received no benefit from his claim to the exemption. The transitional rule is unreasonably harsh and oppressive, and arbitrarily ignores Mr. Hirschi's recognized right, in effect at the time Mr. Hirschi made the gifts, to make up to $30,000 in gifts, claim an exemption from gift taxes in respect of those gifts, and

suffer no potential increase in estate tax by virtue of the claimed exemption.

The application of 26 U.S.C. 2010(c) to reduce the unified credit available to Mr. Hirschi's estate results, in effect, in double taxation of Mr. Hirschi's gifts.[23] At the time Mr. Hirschi made the gifts, no portion of the gifts were subject to the gift tax by reason of the application of Mr. Hirschi's $3,000 per year per donee annual exclusion (26 U.S.C. (1970 ed.) 2503(b)) and his $30,000

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[23] In Appellee's claim for refund, they assert:

> It is the position of this estate that it was not the intention of the drafters of the Internal Revenue Code that both the amount of the gift be included in the estate and the unified credit be reduced by 20% of the pre-1977 specific exemption under Section 2010(c), but it was the intention of the drafters of the Internal Revenue Code that in the event of the occurrences which are involved in this case, the gross estate would include all of the gift in contemplation of death and the unified credit against estate tax would not be reduced by 20% of the pre-1977 exemption.
>
> *In essence*, such inequitable treatment results in double taxation. Section 2010 allows a unified credit for every estate against the tax imposed by Section 2001 . . .

J.A. 21 (emphasis added).

and that

> Section 2001 provides for a 34% rate of tax upon the top bracket of the estate of Charles Hirschi. The tax imposed by Section 2001 is calculated upon the gross estate which includes, under Section 2035, the transfers made on September 28, 1976. Through the process of inclusion of these transfers in the gross estate, and a reduction in the allowable unified credit, *the effect* results in a doubling of the 34% rate of tax. Furthermore, there is no statute which provides for Section 2035 inclusion and double taxation.

J.A. 22 (emphasis added).

specific exemption (26 U.S.C. (1970 ed.) 2521). Further, at the time Mr. Hirschi made the gifts and claimed the specific exemption, the claim of exemption would not have increased the estate taxes payable by Mr. Hirschi's estate. To the extent Section 2010(c) applies to reduce the unified credit available to Mr. Hirschi's estate, Section 2010(c) effectively imposes a retroactive penalty tax upon Mr. Hirschi's claim to the specific exemption. Unlike the situation presented in *Milliken v. United States*, 284 U.S. 15 (1931), Section 2010(c), if applied to Mr. Hirschi's estate, imposes a totally new and different tax upon Mr. Hirschi's gifts and claim to his statutory specific exemption. Mr. Hirschi's otherwise available unified credit was reduced by $6,000. Thus, upon his death, Mr. Hirschi's estate would pay $6,000 more in tax than would otherwise have been payable but for Mr. Hirschi's gifts and claim to his specific exemption during the transitional period.

In general, a statute which reaches back to attach new legal rights and duties to an already completed transaction is retroactive. *Forbes Pioneer Boat Line v. Board of Comm'r of Everglades Drainage District*, 258 U.S. 338, 339-40 (1922). The clearest form of retroactive legislation gives pre-enactment conduct a different legal effect from that which it would have had without the passage of the legislation. *See generally*, Cooley, *The Limits to Legislative Power in the Passage of Curative Laws*, 12 Cent. L.J. 2 (1881). Retroactive legislation has traditionally been regarded as undesirable for several reasons: it infringes upon an individual's desire to plan conduct without surprise, with reasonable certainty and free from the "fluctuating policy" of the legislature (The Federalist No. 44, at 279 (Lodge ed. 1888) (Madison)); and it eliminates

reasonable certainty as to past transactions. Moreover, while a court's pronouncement may apply to past conduct, a legislature's function is, in general, to declare law for the future. *See generally*, Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence*, 29 Minn. L. Rev. 775, 789 (1936).

In the income tax area, uniformly and fairly applied retroactive legislation predominates, though blurred distinctions are drawn between income and estate and gift taxes. In general, income taxes apply to calendar or fiscal year transactions. Historically, this Court has rarely overridden retroactive income tax legislation given the Government's paramount interest in securing operating revenues and in apportioning governmental operating costs among those protected. It is thought that a taxpayer subject to the application of retroactive income tax laws would have received the income without regard to the presence or absence of the retroactive legislation and accordingly cannot be considered to have been "surprised" by the retroactive legislation. Thus, statutes taxing all income received during a calendar year have been sustained even though enacted during the latter part of the year. *See, e.g., Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1, 20 (1916); *Stockdale v. Atlantic Ins. Co.*, 87 U.S. (20 Wall.) 323 (1874); cf. *Cooper v. United States*, 280 U.S. 409 (1930); *Lynch v. Hornby*, 247 U.S. 339 (1918). Moreover, even if pre-enactment conduct could have been altered had the taxpayer had notice of the proposed legislation, retroactive income tax legislation has been constitutionally validated. *United States v. Darusmont*, 449 U.S. 292 (1981). The same rationale has historically not been applicable to estate and gift taxes.

As to the estate tax, a death transfer tax requires a creation of a balance sheet reflecting the value of assets owned at death and interests transferred in certain ways to others before death. *See, e.g.*, 26 U.S.C. (1970 ed.) 2035 (Transfers in Contemplation of Death), 2036 (Transfers With a Retained Life Estate), 2037 (Transfers Taking Effect at Death), and 2038 (Revocable Transfers). As new and different ways of retaining strings with respect to or otherwise controlling wealth are spawned outside the then existing legislative nets, Congressional responses are required.[24] Moreover, as to the element of surprise: the

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[24] In *United States* v. *Byrum*, 408 U.S. 125, *reh. denied*, 409 U.S. 898 (1972), the decedent, a 71 percent shareholder in three related corporations, transferred a portion of his stock in each corporation to a trust which he established for the benefit of his children. Although the independent trustee was granted discretion to control the trust property for the sole benefit of the beneficiaries, Mr. Byrum reserved the rights to vote the stock of the corporation, veto the sale of the stock, and replace the trustee.

While conceding that the retention of voting rights in an "unimportant minority interest" would not produce any tax under 26 U.S.C. (1970 ed.) 2036 or 2038, the Government argued that the cumulative effect of the retained powers left the decedent with absolute control of the corporations which was the equivalent of "possession and enjoyment" of the transferred stock, within the meaning of 26 U.S.C. (1970 ed) 2036(a)(1). As retained control left Mr. Byrum with power to control the income flow, he retained a power to "designate . . . who shall possess or enjoy the property or the income therefrom" under 26 U.S.C. (1970 ed) 2036(a)(2), and power to affect "the enjoyment" of the property under 26 U.S.C. (1970 ed) 2038(a)(1). This Court held that the retained powers were essentially "administrative" not "dispositive" or of sufficient "present economic benefit" to come within the pale of 26 U.S.C. (1970 ed) 2036 or 26 U.S.C. 2038.

The Congressional response: 26 U.S.C. 2036(a)(1). The Committee Reports specify that the amendment to 26 U.S.C. (1970 ed) 2036(a) is in response to the *Byrum* decision. See H. Rep. 94-1380, *supra*.

prospective decedent still has some, though perhaps little time, within which to manage or rearrange his financial affairs. As to the desire to have reasonable certainty as to past transactions: the estate tax, from its inception, has operated upon death bed circumstances.

As to the gift tax, the otherwise paramount revenue collecting interest of the government should be placed at least on an equal footing with that of the individual's need to know the consequences of the individual's proposed act before the act is committed. Individuals are free to contract against income tax changes: both contracting parties are at least alive and able to renegotiate positions. Changes in the estate tax are less subject to alternative plans but nonetheless may be planned for or against. But retroactive gift tax laws are the worst of the breed: once an individual has made the gift, the individual may not renegotiate the gift or plan around it. The transaction is, by definition, irrevocable. Congress[25] and this Court have traditionally

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[25] The application of gift tax legislation to completed transactions has been regularly avoided by Congress. The gift tax included by the Act of 1932, Section 501, 47 Stat. 245, was made specifically inapplicable "to a transfer made on or before the date of the enactment of this Act," Section 501(b) (the Act was passed on June 6, 1932). The change in rates provided by the Act of 1934, Section 520(a), 48 Stat. 761, 26 U.S.C.A. § 1136(b), applied only to calendar years beginning with 1935, though given the cumulative nature of the tax, computations must be made as if the new rates were applicable during prior years. The Internal Revenue Code of 1954 applied only to gifts made after December 31, 1954. Section 2501, 26 U.S.C. Finally, new 26 U.S.C. 2010(c) applies to gifts made after September 8, 1976, the date the Conference Committee approved the transitional rule as eventually enacted but before the date the President signed the legislation on October 4, 1976.

(Continued on following page)

required that retroactivity be avoided, if possible. *Blodgett v. Holden*, 275 U.S. 142 (1927), modified, 276 U.S. 594 (1928); *Untermyer v. Anderson*, 276 U.S. 440 (1928). At least one commentator has painted the backdrop against which retroactive legislation should be tested.[26]

Notwithstanding the Government's assertion that the application of the constitutionally permissible retroactivity doctrine controls the disposition of this case, in none of the principal cases cited by the appellant was the issue in this case squarely faced: 26 U.S.C. 2010(c), as applied to this transaction, is so arbitrary and capricious as to render it unconstitutional because Mr. Hirschi's estate is penalized for Mr. Hirschi's attempt to obtain a legislatively provided tax benefit. Mr. Hirschi was offered an election which permitted him to make the $30,000 gifts tax free. Under no construction of that legislation could Mr. Hirschi be presumed to know that if he availed himself of that otherwise beneficial election and then died within the period which would cause the gifts to be included in his estate for estate tax purposes, would he not only forfeit the election claimed but be penalized by the shrinkage of his unified credit to the extent of $6,000. None of the cases deal with an election conferred, then taken, and substituted with a penalty, retroactively applied for up to three years.

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All events occurred with respect to the Hirschi gifts—the gifts were irrevocably made on September 28, 1976 and the gift tax return was filed as required which indicated no tax due (J. S. App. 2a-3a; J. A. 5, 8-13), before the date of enactment though the bill had passed both Houses of Congress on September 16, 1976.

[26] Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 697 (1960).

C. The Application of the 1976 Act to The Hirschi Estate Does Deprive Appellees of Property.

The Government contends that if the provisions of the estate tax as it stood in September, 1976 had been applied to Mr. Hirschi's estate, the tax would have been $655.16 more than the tax paid by the estate under the Act. Thus, the Government argues that Mr. Hirschi's estate paid $655.16 less in tax by reason of the applicability of the Act, and accordingly has not been deprived of property. The Government's argument fails to consider the increase of $6,000 in taxes payable by the estate due to reduction of the unified credit. The $6,000 reduction in the unified credit has the same effect as the imposition of an additional tax of $6,000. *Cf. Regan v. Taxation with Representation*, 461 U.S. 540, 544 (1983). Moreover, the Act was intended to reduce estate taxes by from ten to fifteen percent. *See* n. 4, *supra*. Application of Section 2010(c) deprives Mr. Hirschi's estate of the tax reduction which the Act was intended to effect.

D. Even if Congress Provided Timely Notice of the Transitional Rule That It Enacted, the Notice Which It Provided Constituted An Unconstitutional Trap for the Wary.

Mr. Hirschi irrevocably gifted his property on September 28, 1976, after the House Ways and Means Committee approved its version of the transitional rule on August 6, 1976, after the Conference Committee approved the version which was eventually enacted, after the bill passed both houses of Congress on September 16, 1976, but before it was signed by the President on October 4, 1976. As applied to Mr. Hirschi, the Act did not alter the tax treatment of a gift which was the subject of an existing tax

(*cf. Milliken v. United States*, 283 U.S. 15 (1931)), but rather subjected to tax Mr. Hirschi's claim to the specific exemption, which would not have been the subject of any tax under prior law. Thus, the transaction should be governed by *Untermyer v. Anderson*, 276 U.S. 440 (1928) and *Blodgett v. Holden*, 275 U.S. 142 (1927), modified, 276 U.S. 594 (1928), which hold that gifts made before enactment are beyond the reach of a retroactive statute.

Assuming the transitional rule was adopted to prevent a "rush to the door" by prospective donors seeking to circumvent the accomplishment of the purpose of the legislation as in *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, No. 83-245 (June 18, 1984), slip op., the House Committee report failed to apprise Mr. Hirschi of the possible forfeiture of $6,000 of his unified credit if he proceeded. Moreover, if the loss of $6,000 of Mr. Hirschi's credit *and* the imposition of more tax was anticipated by Congress, then the House report was defective in that it suggested just the contrary: that he or his estate would benefit from his claim to his specific exemption. If Mr. Hirschi is to be charged with constructive notice of the pending congressional action, then at least the Committee Report (H.R. Rep. 94-1380, *supra*) should not have suggested that he claim his specific exemption, as not to do so would result in a loss of a benefit, instead the report should have cautioned against the imposition of an additional tax. The situation in which Appellees find themselves is, at the very least, "inequitable" and the inequity stems not from the fact of human mortality or from a flawed reading of the Internal Revenue Code, but from the interpretation proposed by the Government. If Congress had intended the result urged by the

Government, then adequate warning should have been given.

If, as contended by the Government, Mr. Hirschi should have "waited a week to see if the President signed the 1976 Act, and then computed the relative advantages and disadvantages of *claiming* the exemption in view of the uncertainties of life." (Government's Brief, p. 17) (emphasis supplied), and if the Committee reports "provided him with constructive notice of what the effect of claiming the specific exemption was very likely to be," (Government's Brief, p. 24), then he would have assumed that by claiming his specific exemption, he or his estate would, in some way, "benefit". With a view toward correctly assessing the relative advantages and disadvantages of claiming the exemption, Mr. Hirschi would have been obliged to perform one more act, within the due date of his third quarter of 1976 gift tax return. Die. Mr. Hirschi would have had to die within the period in order for his estate to determine if Mr. Hirschi should or should not claim his specific exemption. The situation in which Appellees find themselves is, at the very least, "inequitable" and the inequity stems not from the fact of human mortality or from a flawed reading of the Internal Revenue Code, but from the interpretation proposed by the Government.

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CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted,

Edward F. Sutkowski
Dean B. Rhoads
Donald C. Rikli
Attorneys for Appellees

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No. 84-1944

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA,
ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF ILLINOIS

REPLY BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

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UNITED STATES OF AMERICA,
ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM
THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF ILLINOIS

REPLY BRIEF FOR THE UNITED STATES

This case is here on direct appeal because the district court held that Section 2010(c) of the Internal Revenue Code[1] is a species of retroactive legislation whose application to appellees was so arbitrary and capricious as to deprive them of property without due process of law. We showed in our opening brief that the district court was wrong for at least four independent reasons. Evidently recognizing the vulnerability of the district court's constitutional holding, appellees in their brief do not place chief reliance upon it. Instead, they principally urge a statutory argument, a variant of which they proffered first in their claim for refund and then to the district court, but upon

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[1]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

which the district court did not explicitly pass. Appellees are seconded in this course by an amicus curiae who shares our view that "Section 2010(c) * * * does not implicate constitutional concerns of retroactivity under any view of the law," but who "is concerned that * * * the Court could inadvertently make an overly broad ruling" on the constitutional issue. Paluch Am. Br. 2, 17.[2]

An appeal under 28 U.S.C. 1252 "brings before this Court not merely the constitutional question decided

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[2]Amicus recites that the source of her concern is a pending tax refund suit in which she contends that "Congress's retroactive elimination of [an estate tax] exemption is constitutionally [im]permissible" (Paluch Am. 2 & n.2). Examination of the pleadings in that suit discloses that it is an outgrowth of *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), aff'd, 757 F.2d 920 (7th Cir. 1985). The district court in *Haffner* held that certain state and local housing bonds are exempt from federal estate tax by virtue of a 1937 housing law. While the government's appeal from that judgment was pending, Congress legislatively overruled the decision. Deficit Reduction Act of 1984, Pub. L. No. 98-369, §§ 641, 642, 98 Stat. 939. In so doing, Congress expressed concern about the possible revenue consequences of the *Haffner* decision, in view of the fact that many millions of dollars in such bonds were still in circulation. See Staff of Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 971-973 (Joint Comm. Print 1985). Section 641(b)(1) of the legislation (98 Stat. 939) generally made the new law effective with respect to decedents dying, gifts made, and transfers made on or after June 19, 1984. Section 641(b)(2), however, provided (98 Stat. 939) that the new law would also apply if an estate or gift tax return had been filed at any time showing a transfer of such bonds as subject to federal estate or gift tax; the effect of this latter provision was to bar refund claims by taxpayers who lacked the foresight to assert ab initio the tax exemption that the district court discovered in the 1937 law. Amicus curiae and others (see Paluch Am. Br. 2-3) are challenging the constitutionality of Section 641(b)(2) on retroactivity grounds. Although we believe that the Seventh Circuit erred in affirming the district court's judgment in *Haffner* (see 757 F.2d at 921-922 (Posner, J., dissenting)), we did not petition for a writ of certiorari because of the absence of a circuit conflict and because the 1984 legislation had reduced the decision's serious revenue implications.

below, but the entire case," including "nonconstitutional grounds presented to, but not passed on, by the lower court." *United States* v. *Locke*, No. 83-1394 (Apr. 1, 1985), slip op. 7. Whether the Court will consider questions of the latter sort generally "depends on the extent to which lower court factfinding and analysis * * * will be necessary or useful to [the] disposition of those questions" (*id.* at 7 n.9). Although the statutory argument that appellees present here (Br. 15-27) differs somewhat from the statutory argument that they presented in their claim for refund (see J.A. 20-22) and in the district court (see U.S. Br. 13-17), the two arguments have the same basic thrust, and the stipulated facts present no complexity. In these circumstances, we submit that it would be appropriate for the Court to consider and reject appellees' statutory argument, and that there is no need for a remand.

1. Section 2010(c) provides that the unified credit "shall be reduced by an amount equal to 20 percent of the aggregate amount *allowed* as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976" (emphasis added). The statutory argument now advanced by appellees (Br. 12-27) and by amicus curiae (Paluch Am. Br. 6-15) hinges on the proper construction of the word "allowed." They contend that Hirschi (the decedent) derived no benefit from his election of the specific exemption in September 1976, and hence that the exemption was not "allowed" to him within the meaning of the statute. Both the premise and the conclusion of this argument are false, and the conclusion in any event does not follow from the premise. We consider them in reverse order.

a. When Hirschi filed his gift tax return (J.A. 8-9) on September 30, 1976, he reported total gifts in the amount of $45,000. He excluded the first $15,000 by virtue of the annual per-donee exclusion, and he claimed a specific

exemption in the amount of $30,000 as to the balance. He thus reported taxable gifts of zero and no gift tax due (*id.* at 9).

Appellees appear to concede (Br. 18 & n.13), as they must, that Hirschi's claim of the specific exemption was not disallowed by the IRS, since his gift tax return was accepted as filed and since no deficiency in gift tax was proposed or assessed.[3] Appellees nevertheless contend that Hirschi's claim was "effectively disallowed" (Br. 14, 18) or "was, in effect, never allowed" (*id.* at 16) because the property as to which he had claimed the specific exemption was ultimately included in his gross estate as a gift "in contemplation of death" (26 U.S.C. (1976 ed.) 2035)). In appellees' view, an exemption or deduction is not "allowed" for federal tax purposes unless the taxpayer has "benefited from [its] use" (Br. 8).

Appellees' argument is squarely foreclosed by this Court's decision in *Virginian Hotel Corp.* v. *Helvering*, 319 U.S. 523 (1943). The question there concerned the determination of a taxpayer's "basis" in property for purposes of computing depreciation upon it. The Code then provided, as there relevant, that the basis of property was to be adjusted for depreciation " 'to the extent allowed' " in prior years under the tax laws (319 U.S. at 525 & n.5, quoting 26 U.S.C. (1940 ed.) 113(b)(1)(B)). The taxpayer in *Virginian Hotel* had claimed deductions for depreciation in prior years, and "[n]o objection [had been] taken by the Commissioner or his agents to the amounts [thus] claimed and deducted" (319 U.S. at 524). The taxpayer nonetheless

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[3]Appellees state (Br. 18 n.13) that "[t]he Service could have disallowed Mr. Hirschi's claimed specific exemption and [could have] assessed a deficiency with respect to [his] gift tax return" before the statute of limitations barred such action. But they do not suggest any ground on which the Commissioner could have predicated such action, nor do they suggest that he took such action in fact.

contended that the basis of its property should not be reduced on account of those previously-claimed depreciation deductions, since, owing to operating losses in the earlier years, the depreciation "did not serve to reduce [its] taxable income" (*id.* at 525). The taxpayer contended, in short, that the term " 'allowed' * * * connotes the receipt of a tax benefit," and that a deduction "claimed by [a] taxpayer and not disallowed by the Commissioner * * * is nevertheless not 'allowed' if * * * deductions other than depreciation are sufficient to produce a loss for the year in question" (*id.* at 526).

This Court squarely rejected the taxpayer's argument (319 U.S. at 527-528 (footnote omitted)):

> Under our federal tax system there is no machinery for formal allowances of deductions from gross income. Deductions stand if the Commissioner takes no steps to challenge them. Income tax returns entail numerous deductions. If the deductions are not challenged, they certainly are "allowed," since tax liability is then determined on the basis of the returns. Apart from contested cases, that is indeed the only way in which deductions are "allowed." And when all deductions are treated alike by the taxpayer and by the Commissioner, it is difficult to see why some items may be said to be "allowed" and others not "allowed." It would take clear and compelling indications for us to conclude that "allowed" as used in § 113(b)(1)(B) means something different than it does in the general setting of the revenue acts.

Citing *Virginian Hotel,* the lower courts have consistently held that deductions are "allowed" for federal tax purposes when they are claimed on a tax return "without objection by the Commissioner" (*Blackhawk-Perry Corp.* v. *Commissioner,* 182 F.2d 319, 321 (8th Cir. 1950)), and that "[i]t is

immaterial that the taxpayer * * * derived no tax benefit from the allowance." *P. Dougherty Co.* v. *Commissioner,* 159 F.2d 269, 271 (4th Cir. 1946). Accord, *e.g., Kilgroe* v. *United States,* 664 F.2d 1168, 1170 (10th Cir. 1981); *Repplier Coal Co.* v. *Commissioner,* 140 F.2d 554, 558 (3d Cir. 1944).

Although appellees acknowledge the force of this Court's decision in *Virginian Hotel,* they seek to distinguish it from this case on the ground that it involved the income tax rather than the gift tax. See Br. 18 & n.14. But this is a distinction without a difference. The Court in *Virginian Hotel* spoke of "our federal tax system" (319 U.S. at 327), and precisely the same "machinery" (*ibid.*) governs the audit of income tax returns and gift tax returns, as well as the allowance or disallowance of deductions, exemptions, and exclusions claimed upon them. It has always been true, since the enactment of the gift tax in 1932, that otherwise taxable gifts as to which the specific exemption (or, where appropriate, the annual exclusion) had been claimed, might subsequently be included in the donor's gross estate, *e.g.,* as a gift in contemplation of death (26 U.S.C. (1976 ed.) 2035) or as a transfer with retained life interest (I.R.C. § 2036). It has never been suggested that a claimed exemption or exclusion, unchallenged by the Commissioner, should in such circumstances be deemed "disallowed." Indeed, the credit for gift taxes, as applied against the estate tax, was likely to be reduced in such circumstances by virtue of the decedent's claim of, and the Commissioner's lack of objection to, the specific exemption or annual exclusion, even though the taxpayer arguably received no "tax benefit" therefrom. See, *e.g., Estate of Chapman* v. *Commissioner,* 32 T.C. 599 (1959) (gift in contemplation of death); Treas. Reg. § 20.2012-1(c) (computation of gift tax credit where gift made in contemplation of death).

When Congress has intended to qualify the word "allowed" in the manner that appellees urge, Congress has done so in plain and unambiguous terms. The word "allowed" is a term of art in the Internal Revenue Code. It is the operative verb in virtually every section that provides for a deduction. *E.g.*, I.R.C. § 165(a) ("There shall be allowed as a deduction any loss sustained during the taxable year * * *."). And its meaning is crucial to the operation of the Code's "basis" rules. See, *e.g.*, I.R.C. § 1016(a)(20) (adjustments to basis "for amounts allowed as deductions for payments made on account of transfers of franchises, trademarks, or trade names"); I.R.C. § 1016(a)(25) (adjustments to basis "for amounts allowed as deductions under section 58(i) (relating to optional 10-year write off of certain tax preferences)"). When Congress has intended, as it has intended with respect to several of these basis provisions, to incorporate the "tax benefit" gloss that appellees seek to find in Section 2010(c), Congress has specified that basis shall be reduced "for amounts allowed as deductions * * * *and resulting in a reduction of the taxpayer's taxes under this subtitle.*" *E.g.*, I.R.C. § 1016(a)(9), (14) and (16) (emphasis added). See I.R.C. § 1016(a)(2)(B) (depreciation deductions). Congress obviously has incorporated no such language in Section 2010(c), and there is thus no reason to give the term "allowed" as used therein a construction different from the long-familiar construction adopted by this Court in *Virginian Hotel*.

In sum, there is no merit to appellees' contention that a specific exemption, properly claimed by a donor on a gift tax return, should be deemed "allowed" within the meaning of Section 2010(c) only if it can be shown to have generated a tax benefit to him or to his heirs. As we pointed out in our opening brief (at 15-16), the statutory argument that appellees made below, which resembles their argument here, has

been rejected by the only other court that has considered it. See *Estate of Renick* v. *United States*, 687 F.2d 371, 376-377 (Ct. Cl. 1982). This Court should reject it also.[4]

b. The premise of appellees' statutory argument—that Hirschi obtained no benefit from his election to claim the $30,000 specific exemption on his September 1976 gift tax return—is in any event incorrect. By virtue of that election, Hirschi paid no gift tax, which otherwise would have been currently due, on the transfer of property then valued at $30,000. By virtue of that election, he obtained the certainty that the property in question would reach his heirs entirely free of tax—both of gift tax and of estate tax—if he survived for three years or died under circumstances negating the inference that he had transferred the property in

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[4]As we have noted (U.S. Br. 6-7), the House Report on H.R. 14844, 94th Cong., 2d Sess. (1976), discussing an earlier version of Section 2010(c), illustrated its operation by stating: "Thus, in the case where a donor *had benefited* from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit allowable would be reduced by $6,000." H.R. Rep. 94-1380, 94th Cong., 2d Sess. 16 (1976) (emphasis added). Contrary to the contention of appellees (Br. 7-8) and of amicus curiae (Paluch Am. Br. 10-11), this passage does not support the construction of the statute that they urge. In the common situation, of course, a decedent *would have benefited* from the use of the specific exemption, and it was thus natural for Congress to invoke that situation when illustrating the mathematics required. But Congress's reference to that fact pattern by way of example hardly constitutes a "clear and compelling indication * * * that 'allowed' as used in [Section 2010(c)] means something different than it does in the general setting of the revenue acts" (*Virginian Hotel*, 319 U.S. at 527-528). Both the House Report (H.R. Rep. 94-1380, *supra*, at 16) and the Conference Report (S. Conf. Rep. 94-1236, 94th Cong., 2d Sess. 607-608 (1976)), like Section 2010(c) itself, state without qualification that the unified credit is to be reduced by reference to amounts "allowed as a specific exemption," and there is no justification in either the statutory language or its legislative history for concluding that Congress did not mean what it said.

contemplation of death.[5] And even if some estate tax, possibly greater or possibly less than the avoided gift tax, ultimately became payable, Hirschi obtained by virtue of his election both a temporal deferral of the tax and a shift in its incidence from himself to his estate. Owing to the time value of money, deferral of taxes is a benefit that taxpayers often seek, even at the cost of extensive litigation. See, *e.g.*, *United States* v. *Hughes Properties, Inc.*, cert. granted, No. 85-554 (Dec. 2, 1985).

With respect to gifts made between September 8, 1976, and January 1, 1977, an analytical taxpayer might have found that ascertaining the balance of benefits and burdens concerning election of the specific exemption was a complex task calling for subtle judgments. Among the factors to be considered would have been the donor's age and the state of his health, the prevailing and anticipated level of interest rates, the gift tax bracket into which prior taxable gifts had placed him, and the anticipated size of his estate. Since election of the specific exemption would produce a 20% reduction in the unified credit, it might have seemed prudent, other things being equal, for a donor in a gift tax bracket below 20% not to claim the specific exemption, but instead to pay the relatively small gift tax that would then

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[5]Appellees appear to suggest (Br. 12, 16) that Hirschi's September 1976 gifts were *automatically* included in his gross estate because made within three years of his death. But while automatic inclusion is the rule for gifts made after December 31, 1976 (see I.R.C. § 2035(a)), gifts made before 1977 and within three years of death were merely *presumed* to have been made in contemplation of death, "unless shown to the contrary" by the taxpayer (26 U.S.C. (1976 ed.) 2035(b)). Thus, the includability of Hirschi's September 1976 gifts in his gross estate ultimately depended (subject to the presumption in former Section 2035(b)) on a factual determination as to whether those gifts were actually made "in contemplation of death." See *Estate of Hutchinson* v. *Commissioner*, 765 F.2d 665 (7th Cir. 1985); *Estate of Gill* v. *Commissioner*, 79 T.C. 437 (1982), aff'd, 711 F.2d 541 (5th Cir. 1983).

have been due. In that way, the donor would keep his unified credit intact, while preserving for his executor the right to claim a credit for the gift tax paid should the transferrred property ultimately be included in his estate. If a donor in a gift tax bracket below 20% (as Hirschi was) were to elect the specific exemption in such circumstances (as Hirschi did), his election would suggest—if we again assume an analytical and well-informed taxpayer—that he placed a high priority on deferring even a relatively small amount of tax, that he was especially confident of surviving for three years or more, or that he was similarly confident that his taxable estate would be small enough so that the reduction in the unified credit would not matter.

Whatever the balance struck by a given taxpayer, the significant fact is that the statute left him free to make an election in light of his circumstances and values, as he perceived them. The statute did not undertake to guarantee that his choice would be wise, or that his estimate of the probabilities would be borne out. There is nothing in this case to indicate that Hirschi ever regretted his election of the specific exemption on his gift tax return for the third quarter of 1976, filed as it was some hours before the end of that quarter. Nor is there anything to suggest that, prior to the November 15, 1976, due date for such returns, Hirschi wished or sought to withdraw the return that he had filed or the election that he had made. After his death, his executors have apparently recognized that, as matters eventuated, another election would have produced fewer dollars payable to the Treasury. But their hindsight does not change the fact that Hirschi during his life enjoyed the benefits—including tax deferral—of the election that he freely made.

2. As to the constitutional question, we believe that our opening brief covers most of the issues that appellees have raised. Two points, however, merit a short reply.

a. We pointed out in our opening brief (at 17-18) that the Tax Reform Act of 1976, Pub. L. No. 94-455, Tit. XX, 90 Stat. 1846 *et seq.*, cannot be said to have deprived appellees of property, since the overall effect of that law, including Section 2010(c), was, as appellees conceded in their motion to dismiss, to "reduce[] the decedent's estate tax by $655.16" (Mot. to Dis. 6). Appellees in their brief on the merits assert somewhat confusingly that our argument "fails to consider the increase of $6,000 in taxes payable by the estate due to reduction of the unified credit" (Br. 38). This assertion on its face is incorrect. The $655.16 tax reduction to which we refer represents the *net* tax savings to appelleess *after* the assessment of a $6,000 tax deficiency stemming from reduction of the unified credit. See U.S. Br. 18. It is of course true that, if Section 2010(c) had not been included in the 1976 Act, the overall effect of that law would have been to reduce appellees' estate tax by $6,655.16 rather than by $655.16. But prior to that law's enactment appellees had no more of a property right in the former sum than they had in the latter, and they had no vested interest in any particular version of the bill that Congress was considering. Appellees may have hoped for a greater tax reduction than they got, but the disappointment of their hopes did not work a deprivation of their property.

b. Appellees appear to agree with our contention (U.S. Br. 23-24 & n.12) that *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), the decision upon which the district court chiefly relied in declaring Section 2010(c) unconstitutional (see J.S. App. 4a-5a), has been limited by this Court's subsequent decisions to the precise facts that *Untermyer* involved—viz., the retroactive application of a *wholly new tax* to transactions irrevocably completed before its effective date. Appellees, however, seek to bring this case within the reach of *Untermyer*, as thus limited, on the theory that Section 2010(c) "effectively imposes a retroactive penalty tax" and

thus "imposes a totally new and different tax" upon them (Br. 33). The subject of this supposed "retroactive penalty tax" is said to be a donor's "recognized right, in effect [prior to 1977], to make up to $30,000 in gifts, claim [a specific] exemption from gift taxes in respect of those gifts, and suffer no potential increase in estate tax by virtue of the claimed exemption" (*id.* at 31-32).

Appellees' argument reminds one of Voltaire's remark about the Holy Roman Empire. Section 2010(c) does not "impose a tax"; it provides for a reduction of a credit against a tax on account of a tax benefit previously claimed and allowed. Section 2010(c) does not effect a "penalty"; penalties under the Internal Revenue Code are clearly denominated as such (*e.g.*, I.R.C. §§ 6671-6708), and Section 2010(c), far from imposing a penalty, sets forth a transitional rule of general application to prevent a lacuna between two tax regimes. And Section 2010(c) is not "retroactive" legislation because, as we showed in our opening brief (at 18-21), it was enacted more than two years before the testator died.

For these reasons and for the reasons set forth in our opening brief, the judgment of the district court should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

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No. 84-1944

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, *ET AL.*,

Appellants

v.

ALVIN HEMME, *ET AL.*,

Appellees

On Appeal from the United States District Court for the Southern District of Illinois

BRIEF OF MARGARET A. PALUCH AS AMICUS CURIAE IN SUPPORT OF APPELLEE

EDWARD C. RUSTIGAN
THOMAS C. DURHAM
Mayer Brown & Platt
231 S. LaSalle Street
Chicago, Illinois 60604
(312) 782-0600

DAVID W. CARPENTER
JAMES J. CARROLL*
HOLLY A. HARRISON
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for Amicus Curiae
*Counsel of Record

QUESTION PRESENTED

Is a gift tax exemption "allowed" to a donor for purposes of § 2010(c) of the Internal Revenue Code when his gift is included, without exemption, in his estate for purposes of computing the unified estate and gift tax.

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No. 84-1944

IN THE

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UNITED STATES OF AMERICA, *et al.*,

Appellants,

v.

ALVIN HEMME, *et al.*

Appellees

On Appeal from the United States District Court for the Southern District of Illinois

BRIEF OF MARGARET A. PALUCH, EXECUTOR OF THE ESTATE OF CHESTER J. PALUCH, DECEASED AS *AMICUS CURIAE* IN SUPPORT OF APPELLEE

The *amicus curiae*, Margaret A. Paluch, submits this brief in support of the appellee taxpayer.[1]

INTEREST OF AMICUS CURIAE

The *amicus curiae*, Margaret A. Paluch, is the executor of the estate of Chester J. Paluch. The *amicus curiae* has filed suit for

[1]The letters in which each of the parties have consented to the filing of the brief have been filed with the Clerk of Court pursuant to Rule 36.2.

the refund of estate tax she had erroneously paid on certain property which was exempt from estate tax under federal law. *Margaret A. Paluch, Executor of the Estate of Chester J. Paluch v. United States of America*, No. 85 C 8153 (N.D. Ill.). After the *amicus curiae* paid the estate tax, Congress passed a law which purported to eliminate the estate tax exemption retroactively. The Government is contesting the *amicus curiae*'s suit for refund on the ground that Congress' retroactive elimination of the exemption is constitutionally permissible.

The instant case involves a statutory transitional rule enacted to reconcile the operation of two different estate and gift tax statutes. It affects a small class of taxpayers who made gifts during a twenty-five day period and died within the subsequent three-year period. The district court held the transitional rule unconstitutional as a retroactive change in the estate and gift tax laws. However, this case, unlike the *amicus curiae*'s suit for refund, does not present a retroactivity issue of constitutional dimension. Indeed, the estate tax here was not assessed until more than two years after the enactment of the statute at issue, and the taxpayer was put on constructive, if not actual, notice of the change of the tax law before he made the gifts in controversy.

The *amicus curiae* is concerned that, because the district court, the Government and the taxpayer have erroneously treated this case as involving the constitutionality of a retroactive tax statute, the Court could inadvertently make an overly broad ruling which could affect her pending suit for refund.[2] Unlike the instant case, the suit for refund filed by the *amicus curiae* involves the

[2]The *amicus curiae* is particularly concerned that this Court will issue an overly broad reversal of the district court's constitutional ruling in reliance on the Government's erroneous assertion in its jurisdictional statement that this case has wide ranging implications regarding Congress' ability to pass any taxing provisions with retroactive effect. (Government's Jurisdictional Statement, p. 10).

retroactive elimination of a long-standing exemption from estate tax, and will present a clear issue concerning Congressional authority to enact retroactive taxes.

The *amicus curiae* is aware of at least two other estate tax refund suits pending in the Northern District of Illinois which involve the same issue as presented in the *Paluch* case—whether Congress may retroactively abrogate an estate tax exemption. *Robert C. Norris, et al.* v. *United States*, No. 85 C 8607 (N.D. Ill.); *George N. Gaynor, et al.* v. *United States*, No. 85 C 8608 (N.D. Ill.). The *amicus curiae* is also aware that there are many other estates throughout the country which are similarly affected by this retroactive legislation and understands that a number of such estates plan to file refund suits. In view of the importance of this issue to a potentially large group of taxpayers, the Court should not unnecessarily address the full range of constitutional issues raised by retroactive estate tax legislation until an appropriate case is before it.

STATEMENT OF THE CASE

This case involves the application of Section 2010(c) of the Internal Revenue Code (the "Code"), enacted as part of the Tax Reform Act of 1976 (the "1976 Act"), to certain gifts made by the decedent on September 28, 1976. The gifts were made several days after the 1976 Act had been passed by both houses of Congress but six days before it was signed into law by the President. The 1976 Act became law on October 4, 1976, and its general provisions were effective with respect to gifts made and decedents dying after December 31, 1976.

The legislation instituted a novel unification of the federal estate and gift taxes. Under prior law the estate and gift taxes

each had a separate rate schedule[3] and a separate specific exemption from tax: $30,000 from gift tax, 26 U.S.C. (1970 ed.) § 2521, and $60,000 from estate tax, 26 U.S.C. (1970 ed.) § 2052. Moreover, the estate tax rate schedule was not cumulative with the gift tax rate schedule, so that a decedent could utilize the lower estate tax brackets even though he had made substantial taxable gifts during his lifetime.

Congress believed that the lower gift tax rates coupled with a specific gift tax exemption favored the wealthy (H.R. Rep. No. 1380, 94th Cong., 2d Sess. 16 (1976)), who could afford to make *inter vivos* transfers. To mitigate this result, the 1976 Act provided for a uniform rate schedule for both types of transfer taxes, so that the two taxes were integrated and cumulative. 26 U.S.C. § 2001(b)(1). In addition, Congress created a single "unified tax credit" to be applied against either or both taxes, as first incurred. 26 U.S.C. § 2010(b), § 2505. The unified credit was conceived, in part, to permit all taxpayers to reap maximum tax benefits, irrespective of their ability to avail themselves of a specific gift tax exemption. H.R. Rep. No. 1380, 94th Cong., 2d Sess. 6 (1976).

In an attempt to facilitate an orderly transition from the old taxation scheme to the new, Congress enacted § 2010(c). Section 2010(c) provides that the unified estate and gift tax credit is to be reduced by 20% of the amount "allowed" as a specific exemption with respect to gifts made during the statutory transitional period, September 8, 1976 to December 31, 1976, the effective date of the Act.

On September 28, 1976, Charles Hirschi made five separate gifts aggregating $45,000 in value. The first $15,000 of those gifts was exempt from federal gift tax under the annual $3,000 per

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[3]Under the prior rate schedule, *inter vivos* gifts were taxed at approximately seventy-five percent of the estate tax rates. *Compare* 26 U.S.C. (1970 ed.) § 2502 (gift tax rate) *with* 26 U.S.C. (1970 ed.) § 2051 (estate tax rate).

donee exclusion. 26 U.S.C. (1976 ed.) § 2503(6).[4] Hirschi applied the full amount of his $30,000 specific exemption against the $30,000 balance, so that no gift tax was assessed. On September 30, Hirschi filed a federal gift tax return reporting the September 28 gifts, and indicating no tax due.

Hirschi died more than two years later, on November 9, 1978. Because the September 28, 1976 gifts were made within three years of Hirschi's death, they were included in his gross estate pursuant to § 2035 of the Code and were reported on his federal estate tax return.[5] Since the estate was in the 34% unified estate/gift tax bracket, the $30,000 gift generated a $10,200 tax. In addition, however, the IRS reduced the unified credit available to Hirschi's estate by $6,000, based on its construction of § 2010(c), thereby increasing the unified estate/gift tax on the $30,000 transfer to $16,200 (an effective aggregate rate of 54%).

The appellees paid the assessed deficiency and filed a claim for refund with the IRS, which was denied. They subsequently initiated this refund suit in the United States District Court for the Southern District of Illinois. They asserted that § 2010(c) may not properly be construed to require reduction of the unified credit where the specific gift tax exemption was claimed against a gift ultimately included in the decedent's gross estate as a gift in contemplation of death. They further argued that, if it were so construed, the provision would be unconstitutional.

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[4]The Economic Recovery Tax Act of 1981, Pub. L. 97-34, § 441(a), 95 Stat. 319, increased the per donee exclusion from $3,000 to $10,000.

[5]Prior to the Tax Reform Act of 1976, gifts made within three years of death were presumptively in contemplation of death. This presumption, however, was rebuttable. 26 U.S.C. (1970 ed.) § 2035. In order to eliminate burdensome litigation regarding a decedent's motivation in making gifts, Congress revised § 2035 to provide that all gifts made within three years of death are included in the gross estate, thereby effectively converting the rebuttable presumption into an irrebuttable presumption for such gifts. 26 U.S.C. (1976 ed.) § 2035. *See* H.R. Rep. No. 1380, 94th Cong., 2d Sess. 12 (1976).

SUMMARY OF ARGUMENT

This case presents the narrow question of whether § 2010(c) of the Internal Revenue Code can be properly applied to the taxpayer in this case. Because Mr. Hirschi's September 28, 1976 gifts were later found to be in contemplation of death, the application of § 2010(c) to his estate would impose a double tax burden on those gifts. They would be taxed once as part of his gross estate pursuant to § 2035, and effectively taxed a second time by the reduction of his unified credit pursuant to § 2010(c). Congress did not intend such a result.

Section 2010(c) provides for the reduction of the unified estate/gift tax credit by 20% of the specific gift tax exemption "allowed" for gifts made during the transitional period. Whether Mr. Hirschi's unified estate/gift tax credit should be so reduced therefore turns on whether he was "allowed" a tax exemption for the gifts he made in September, 1976. The *amicus curiae* submits that Mr. Hirschi was not allowed an exemption for such gifts because they were, in fact, included in his taxable estate as transfers made within three years of death. (26 U.S.C. § 2035). Indeed, $10,200 of the unified tax assessed at his death was attributable to the inclusion in his taxable estate of the $30,000 of gifts for which he had claimed a gift tax exemption.

The Government's argument that the gift tax exemption was allowed to Hirschi elevates form over substance. It also flies in the face of the general Congressional intent to integrate the estate tax with the gift tax and the specific Congressional intent to reduce a decedent's unified estate and gift tax credit only where the decedent had "benefited" from a specific exemption claimed during the transitional period. In view of the fact that the gifts in question were indisputably subjected to the unified estate *and gift* tax at Hirschi's death as if such gifts had never been made, it is patent that Hirschi did not benefit in any sense of the word from claiming the specific gift tax exemption. It can hardly be main-

tained that a gift tax exemption was actually allowed for a gift when its full value is included—without exemption—in the donor's gross estate for purposes of calculating the unified estate and gift tax.

The *amicus curiae*, therefore, urges the Court to affirm the district court's decision on the ground that the specific gift tax exemption was not ultimately "allowed" to Hirschi within the meaning of § 2010(c).

If the Court does not affirm on statutory interpretation grounds, the *amicus curiae* does not believe that this case presents any substantial problem of retroactivity and urges this Court to decline any invitation to attempt to decide in this case all the circumstances under which tax laws can operate retroactively. Here, the absence of a substantial constitutional question is established by the fact that the taxpayer's complaint that § 2010(c) imposes a double tax penalty would equally exist if Hirschi had made his gifts *after* the 1976 Act was signed into law, rather than 6 days before, and that *less* tax was imposed under the 1976 Act than would have been under the predecessor law. Thus, what the taxpayer finds objectionable is not really the retroactivity of the statute but rather the impact of the Government's discriminatory construction.

ARGUMENT

I. SECTION 2010(c) SHOULD NOT BE INTERPRETED TO REDUCE THE UNIFIED ESTATE/GIFT TAX CREDIT AVAILABLE TO THE HIRSCHI ESTATE

Although the district court found that § 2010(c) violates the Due Process Clause of the Fifth Amendment, it is unnecessary for the Court to reach that constitutional issue. Properly interpreted, § 2010(c) does not require a reduction in the unified estate/gift tax credit based on a specific exemption claimed by a decedent against a gift which is later included in his gross estate. The Court should therefore affirm the district court's decision on statutory

interpretation grounds, and avoid needless adjudication of an important constitutional issue. *See Railroad Commission of Texas* v. *Pullman Co.*, 312 U.S. 496, 498 (1941).

Section 2010(c) provides:

> The amount of the [unified] credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount *allowed* as a specific exemption under Section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976. 26 U.S.C. (1976 ed.) § 2010(c) (emphasis added).

Thus, whether Hirschi's unified credit should be so reduced hinges on whether he was "allowed" the specific gift tax exemption within the intendment of § 2010(c).

In a technical sense, one might argue, as the Government does, that the exemption was "allowed" to Hirschi simply because he claimed it on his gift tax return reporting the September, 1976 gifts. (Government Br. 13–17). Such a definition, however, elevates form over substance because it ignores the reality that the gifts were, in fact, returned to Hirschi's taxable estate as if they had never been made. No exemption was allowed for the gifts for purposes of calculating the unified estate and gift tax, and as a result, the estate paid $10,200 of additional tax.

At the risk of sounding redundant, the *amicus curiae* submits that the true test for determining whether an exemption has been allowed for certain property is whether such property was in fact exempted from tax. Here, the gifts in question were fully subjected to the unified estate *and gift* tax. Accordingly, it can hardly be claimed that any exemption was "allowed" to Hirschi for the gifts which he made in September, 1976. Any exemption he claimed for the gifts turned out to be illusory, for the property was ultimately taxed just as if he had never given it away.

The objective of § 2010(c), as the Government acknowledges in its brief, is to avoid giving taxpayers who make gifts during the

transitional period a "double tax benefit in the form of a $30,000 specific exemption under the old regime coupled with an undiminished unified credit under the new." (Government Br. 8). *See Estate of Gawne* v. *Commissioner*, 80 T.C. 478, 483 (1983); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* ¶ 3.02, at 304, p. 9 (5th ed. 1983). A taxpayer can have one or the other, but not both. However, under the Government's construction of the transitional rule, Hirschi would have neither. In addition to paying a $10,200 unified tax on the $30,000 in gifts (34% x $30,000), the Hirschi estate would suffer the penalty of a $6,000 reduction in its unified credit, so that the total tax on the $30,000 transfer would be $16,200.

Without the transitional rule, a taxpayer who made a $30,000 gift between September 8 and December 31 of 1976 could receive a $30,000 specific exemption under the old law and an undiminished unified credit under the new law. Because of publicity concerning the passage of the 1976 Act, it is likely that many taxpayers would have taken advantage of this "gap" between the provisions of the old and the new law. The purpose of Congress in enacting § 2010(c) was to impose a 20% "tax" on any gifts allowed a specific exemption under the old law, which would otherwise escape taxation (through an undiminished unified credit under the new law). The 20% rate approximated the average gift tax rate under prior law. Congress could not have intended that a taxpayer would pay both the 20% tax and a full tax on the same gift under the new law.

The transitional rule was clearly intended to provide an equitable reduction in the unified credit commensurate with any specific exemption allowed for gifts made during the transitional period, thereby roughly equalizing the tax liability of persons making gifts before and after the effective date of the 1976 Act. The reduction of a decedent's unified credit for an exemption claimed against a gift in contemplation of death in no way furthers this purpose and indeed undermines it. Even in the ab-

sence of the transitional rule, such gifts would be included in the donor's gross estate for purposes of computing the unified tax, so it would be impossible for such a donor to reap a "double tax benefit." Indeed such a gift is effectively treated as if it were never made for estate tax purposes. It is therefore irrational to assume that Congress intended the transitional rule to apply to gifts in contemplation of death.

In contrast to Hirschi, a donor who made the same gifts but had the good fortune of surviving for at least three years would cause his estate to incur only $6,000 of unified tax, which is the 20% tax Congress intended to impose on transitional period gifts. Wholly apart from the inequities of "human mortality" (Government Br. 17), there is something fundamentally unjust and unfair about a tax which treats the two situations so unequally. And the legislative history of the 1976 Act and the underlying Congressional intent in integrating the estate tax with the gift tax indicate that such a construction is plainly wrong.

As the Government brief points out, the House Ways and Means Committee referred to the transitional rule in its Report on H.R. 14844. (Government Br. 7–8). Its explanation of the transitional rule was incorporated by reference in the Conference Committee Report on the 1976 Act. *See* Sen. Rep. No. 1236, 94th Cong., 2d Sess. 607 (1976). The Committee stated:

> As a transitional rule, the unified credit is to be reduced by an amount equal to 20 percent of the amount allowed as a specific exemption in computing taxable gifts under the present law. Thus, in the case where a donor had *benefited* from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit would be reduced by $6,000. (Emphasis added.)

H.R. Rep. No. 1380, 94th Cong., 2d Sess. 16 (1976). Thus, the legislative history of § 2010(c) suggests that a decedent should lose a portion of his unified credit only where he benefits from his use of the specific exemption. A decedent, like Hirschi, who claimed a specific exemption for a gift made within three years

prior to his death, derives no benefit from that exemption and indeed the exemption is effectively disallowed when the gift is included in his gross estate. Clearly, Hirschi "has not benefited from the use of the full $30,000 gift tax exemption" (H.R. Rep. No. 1380, 94th Cong., 2d Sess. 16 (1976)) because the gifts for which such exemption was claimed were thrown back into his estate at his death and taxed as if he had never made them.

Where latent ambiguities in the language of a statute exist, the Court has cautioned that "literalness can strangle meaning." *Lynch* v. *Overholser*, 369 U.S. 705, 710 (1962), quoting *Utah Junk Co.* v. *Porter*, 328 U.S. 39, 44 (1946). It has repeatedly warned against an approach to statutory construction which confines itself to the bare words of a statute. *See, e.g., Church of the Holy Trinity* v. *United States*, 143 U.S. 457, 459-462 (1892); *Markham* v. *Cabell*, 326 U.S. 404, 409 (1945); *Lynch*, 369 U.S. at 711, 715. Accordingly, it has rejected a literal meaning when it would not be consonant with the purposes of the Act. *Lynch, supra*, 369 U.S. at 710; *Haggar Co.* v. *Helvering*, 308 U.S. 389, 399 (1940).[6]

Further, the Court has held that, "taxation is an intensely practical matter and laws in respect of it should be construed with a view to avoiding, so far as possible, unjust and oppressive consequences." *Farmers Loan Co.* v. *Minnesota*, 280 U.S. 204, 212 (1929). The Government's construction would result in such unjust and oppressive consequences and, accordingly, should be rejected.

The legislative history and design of the 1976 Act mandate that any ambiguity inherent in § 2010(c) must be resolved in favor of the taxpayer. The undeniable effect of the Government's construction of § 2010(c) is to subject Hirschi's gift to multiple transfer

[6]In *Haggar*, the Court refused to interpret § 215 of the National Industrial Recovery Act literally to preclude a timely amendment of a tax return, on the theory that such an interpretation would be inconsistent with the clear statutory purpose. *Haggar*, 308 U.S. at 393-94.

taxation under the 1976 Act. Such gifts are taxed once as a reduction in the unified estate and gift tax credit that his estate can claim, and taxed again as a portion of his taxable estate. Congress clearly did not intend such a result. Not only would such construction undermine the unified transfer taxation scheme that Congress sought to institute through the Act, but it would also conflict with its affirmative efforts to assure that *inter vivos* gifts returned to the gross estate would not be taken into account more than once for transfer tax purposes.

The Court, in construing the language of § 2010(c), must " 'find the interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested.' " *Commissioner of Internal Revenue* v. *Engel*, 464 U.S. 206 (1984), quoting *NLRB* v. *Lion Oil Co.*, 352 U.S. 282, 297 (1957) (Frankfurter, J. concurring in part and dissenting in part). Congress designed the gift and estate tax provisions of the 1976 Act to effect a unification of the two taxation schemes. It premised the statutory revisions on the theory that "the tax burdens imposed on the same amount of wealth should be substantially the same whether the transfers are made both during life and at death or made only upon death." H.R. Rep. No. 1380, 94th Cong., 2d Sess. 11 (1976).

Pursuant to its clearly articulated goal, Congress instituted a Unified Rate Schedule (26 U.S.C. (1976 ed.) § 2001) to be applied to all property transfers, whether *inter vivos* or testamentary:

> The Congress believed that it was desirable to reduce the disparity of treatment between lifetime and deathtime transfers through the adoption of a single unified estate and gift tax rate schedule providing progressive rates based upon cumulative lifetime and deathtime transfers.

Joint Committee Explanation 526, 1976-3 (Part 1) C.B. 538. It replaced the disparate tax exemptions with a unified credit intended to be used to its full extent by all taxpayers regardless of

the manner in which they disposed of their property. 26 U.S.C. (1976 ed.) § 2010. The House Ways and Means Committee explained the purpose of the credit as follows:

> As a practical matter, the gift tax exemption is not available to individuals who cannot afford to make lifetime transfers. Thus the overall transfer tax exemption is effectively greater for individuals who are financially able to utilize the gift tax exemption through lifetime transfers. Your committee believes it would be more equitable if a unified credit in lieu of an exemption were available on an equal basis without regard to whether the transfers are made only at death or are made both during lifetime and at death.

H.R. Rep. No. 1380, 94th Cong., 2d Sess. 16 (1976). In unifying the estate and gift taxes, Congress intended "to preclude having the same lifetime transfers taken into account more than once for transfer tax purposes." *Id.* at 13.

The Government's interpretation of § 2010(c) is seriously at odds with Congress' effort to integrate federal estate and gift taxation and to avoid duplicative taxation of lifetime transfers. It would subject a narrow class of gifts to excessive taxation in the face of Congress' clear intent to effectuate even-handed taxation of property transfers. In addition, it would obstruct the Congressional effort to afford each and every taxpayer the full advantage of the unified credit. If applied to the Hirschi estate, it would penalize a discrete group of taxpayers—those making gifts in contemplation of death during the transitional period—in a way no other class of taxpayers would be.[7]

The Court should also consider the purpose and effect of other specific provisions of the Act in interpreting the ambiguous

[7]No other class of taxpayers would be similarly disadvantaged. All other taxpayers subject to § 2010(c)—that is, those surviving more than three years after making their gifts—would reap the benefits of their specific exemption, which would equitably offset the reduction in their unified credit. Similarly, all taxpayers making gifts in contemplation of death after the effective date of the act would receive full use of their entire tax credit as insured by the calculations set forth in 26 U.S.C. (1976 ed.) § 2001.

language of § 2010(c). *Richards* v. *United States*, 369 U.S. 1 (1962).[8] Different provisions within an act should be construed, if at all possible, to be harmonious with one another. *See, e.g., Citizens to Save Spencer County* v. *United States Environmental Protection Agency*, 600 F.2d 844 (D.C. Cir. 1979); *National Bank and Trust Co. of South Bend* v. *United States*, 589 F.2d 1298 (7th Cir. 1978). A construction of § 2010(c) which would call for imposing increased unified tax liability on gifts made in contemplation of death directly conflicts with the careful design of other gift and estate tax provisions.

Section 2001, which sets forth the formula by which estate taxes are calculated, was devised precisely to avoid duplicative taxation. H.R. Rep. No. 1380, 94th Cong., 2d. Sess. 13 (1976). It provides that, for purposes of calculating the unified tax, the decedent's "adjusted taxable gifts" are to be aggregated with his taxable estate, but not if such gifts are already included in the taxable estate. 26 U.S.C. (1976 ed.) § 2001(b). This calculation insures that any portion of the unified credit which had previously been claimed for an *inter vivos* gift later deemed in contemplation of death will not reduce the credit that would otherwise have been available to offset estate tax liability. This legislative policy against double taxation of property transfers is further exemplified by the provision allowing a credit against estate tax for gift tax already paid on gifts in contemplation of death.[9] 26 U.S.C. § 2012.

[8] As the Court stated in *Richards*:

> We believe it fundamental that a section of a statute should not be read in isolation from the context of the whole Act, and that in fulfilling our responsibility in interpreting legislation, "we must not be guided by a single sentence or member of a sentence, but [should] look to the provisions of the whole act, and to its object and policy." *Richards*, 369 U.S. at 10-11, quoting *Mastro Plastics Corp.* v. *Labor Board*, 350 U.S. 270, 285 (1958).

[9] Under neither the old nor the new laws is the taxpayer penalized, except pursuant to § 2010(c), for exemptions taken against gifts in contemplation of death. Under the prior law, if a gift was deemed in con-

(Footnote continued on following page)

Congressional policy against double taxation of gifts in contemplation of death is further manifested in the specific Code provisions respecting such transfers. The clear purpose of requiring that such gifts be returned to the gross estate is to treat and tax them as if they were testamentary transfers. Gifts in contemplation of death "are motivated by the same considerations as lead to testamentary dispositions of property, and [are] made as substitutions for such dispositions without awaiting death. . . ." *Milliken* v. *United States*, 283 U.S. 15, 23 (1931). It is clearly equitable, therefore, that they should be taxed as testamentary. These considerations of equity, however, are completely undermined by effectively taxing such gifts as both *inter vivos* and testamentary transfers.[10]

Finally, this transitional rule, like all other tax measures, is to "be construed liberally in favor of the taxpayers." *Bowers* v. *New York & Albany Co.*, 273 U.S. 346, 350 (1927). All doubts, therefore, should be resolved against the government. *See Shwab* v. *Doyle*, 258 U.S. 529, 536 (1922).[11]

(Footnote continued from previous page)
templation of death, it was returned to the gross estate, and any gift tax paid would be credited against estate tax due. Because the specific gift tax exemption available under the prior law could be claimed for *inter vivos* transfers only, there was no need to compensate for the loss of that credit in assessing the estate tax. Under the new provisions, a credit for previously paid gift tax is permitted for gifts made prior to the effective date of the Act. 26 U.S.C. (1976 ed.) § 2012(e). For gifts made after that date, the tax calculation formula of § 2001 factors in the loss of unified credit on gifts returned to the gross estate.

[10]In addition, if Congress had intended to so drastically alter the tax consequences attaching to gifts in contemplation of death, it would have done so by enacting legislation affecting all such gifts, not merely gifts made over a specific four-month period. Congress did indeed amend § 2035, governing gifts in contemplation of death, by removing the rebuttable presumption and substituting an irrebuttable inclusion of such gifts. It is notable that the amended provision made no reference whatsoever to increasing the tax liability for those gifts.

[11]The government has placed great reliance on the United States Court of Claims decision in *Renick* v. *United States*, 687 F.2d 371 (Ct.

(footnote continued on next page)

II. SECTION 2010(C) DOES NOT PRESENT A SUBSTANTIAL CONSTITUTIONAL QUESTION

While the district court's judgment can and should be affirmed on statutory grounds, the taxpayer has also urged that if this Court accepts the Government's construction of § 2010(c), it should affirm the district court's finding that the provision is an unconstitutional retroactive tax. The *amicus curiae* disagrees and urges the Court here to decline any invitations to address the circumstances under which tax laws can be applied retroactively. While the Fifth Amendment undeniably restricts Congress' ability to impose a tax retroactively,[12] this case does not present a retroactivity question of constitutional significance. The unfairness inherent in the Government's construction of § 2010(c), of which the taxpayer complains, would exist if the subject gifts had been made six days after the 1976 Act was signed into law, rather than six days before. That the taxpayer is complaining about this discriminatory construction, *not* the retroactivity of the 1976 Act, is confirmed by the fact that the Hirschi estate paid *less* tax under the 1976 Act than it would have under the predecessor law. Moreover, the presence of notice and other pertinent circumstances would appear to foreclose a retroactivity claim in any event.

Because the Constitution exists in large measure to protect substantial reliance interests, the question whether a retroactive tax law can survive constitutional scrutiny depends on a number of factors. A critical inquiry is therefore whether the taxpayer had actual or constructive notice of the change in the law at a time

Cl. 1982). The court in *Renick* held that the unified credit was not "restored" under 2010(c) for gifts in contemplation of death, but ignored the question of whether the exemption was "allowed" for gifts ultimately subjected to the unified estate/gift tax. *Id.* at 377. The *amicus curiae* submits that the court did not consider many of the important factors set forth above, and respectfully disagrees with its conclusion.

[12] *See, e.g., Nichols* v. *Coolidge*, 274 U.S. 531 (1927) (estate tax); *Blodgett* v. *Holden*, 275 U.S. 142 (1920) (gift tax); *Untermyer* v. *Anderson*, 276 U.S. 440 (1928) (gift tax); *Coolidge* v. *Long*, 282 U.S. 582 (1931) (estate tax).

when the penalty could be obviated or avoided. *United States* v. *Darusmont*, 449 U.S. 292 (1981); *Blodgett* v. *Holden*, 275 U.S. 142, 147 (1920); *Untermyer* v. *Anderson*, 276 U.S. 440, 448 (1928). Other considerations may include the length of the period of retroactivity, and the extent to which the new statute penalizes pre-enactment conduct. For example, a law that imposes a transfer tax on previously exempted property has long been held invalid as applied to transfers made long before the change in the law was propounded or enacted. *See, e.g., Nichols* v. *Coolidge*, 274 U.S. 531 (1927); *Coolidge* v. *Long*, 282 U.S. 582 (1931).

In arguing that § 2010(c) is constitutional, the Government has improperly focused on whether § 2010(c) is a "new tax," citing *United States* v. *Milliken*, 283 U.S. 15. (Government Br. 21–24). It has erroneously argued the prior decisions of this Court invalidating retroactive estate and gift taxes have no continued vitality except as applied to totally new types of taxes. (Government Br. 23). While the Government wholly misconstrues the clear import of *Milliken*,[11] this Court need not and should not consider the relevance of *Milliken* to this case. Section 2010(c) simply does not implicate constitutional concerns of retroactivity under any view of the law.

The taxpayer's objection to § 2010(c), viewed in its true light, has nothing to do with the retroactive application of § 2010(c) to Hirschi's previously claimed gift tax exemption. Section 2010(c), as the Government construes it, operates to impose duplicative tax liability on a single property transfer. That liability, however, would occur regardless of whether Hirschi has made the gifts before or after the provision was enacted. It also cannot be doubt-

[11]The estate tax statute considered in *Milliken* merely increased the overall rate of taxation applicable to gifts in contemplation of death. *Id.* at 19. In upholding the law, the Court emphasized that a taxpayer assumes the risk that the rate of taxation may rise where the legislative policy to tax a certain transaction is clearly established. *Id.* at 23. A taxpayer, however, may certainly not be charged with notice that a wholly new penalty will be imposed on a transaction, in complete contravention of pre-existing legislative policy.

ed that the taxpayer would have instituted a refund action in any event. Given the fact that the inequity of the Government's construction of § 2010(c) in no way stems from its retroactive application to Hirschi, this case does not present an appropriate opportunity for the Court to enunciate the parameters of Congressional authority to enact retroactive tax measures.

Further, even taking into consideration the double taxation imposed by § 2010(c), the Hirschi estate tax liability is less than it would have been under the prior laws. The taxpayer can hardly claim that the Hirschi estate has been retroactively deprived of any property in violation of the Fifth Amendment.

Moreover, the fact that Hirschi clearly had actual or constructive notice of the potential adverse tax consequences at all relevant times would diminish, if not foreclose, any retroactivity claim in all events. At the time he made his *inter vivos* gifts on September 28, 1976, the Tax Reform Act had been approved by the Conference Committee and had been passed by both houses of Congress. Six days later, on October 4, the President signed the bill into law. The Court held in *United States v. Darusmont*, 449 U.S. 292 (1981), that even pre-enactment public debate regarding the provisions of the Act provided ample constructive notice to taxpayers of the imminent statutory changes. *Id.* at 299. In addition, the timing of Hirschi's September 28 gift, coupled with the hasty filing of his gift tax return on September 30, create a strong inference that he had actual notice of the transitional rule.

Section 2010(c) was necessary to reconcile the operation of two different statutes during a transitional period, and to prevent taxpayers from reaping a "double benefit" in the transition from the old law to the new law. The "retroactive" injury of which the taxpayer complains is limited to the small class of taxpayers who made gifts between September 8 and October 4, 1976, and who had the misfortune to die within the following three years. Section 2010(c) was merely a mechanism to effect the transition from the old law to the new.

Conclusion

For the foregoing reasons the Court should uphold the district court's decision on the ground that § 2010(c) may not properly be interpreted to apply to the Hirschi estate. If the Court finds it necessary to reach the constitutional issue in this case, it should hold that the statute does not present a substantial constitutional question as to the validity of a retroactive tax measure.

Respectively submitted,

Edward C. Rustigan
Thomas C. Durham
Mayer Brown & Platt
231 S. LaSalle Street
Chicago, Illinois 60604
(312) 782-0600

David W. Carpenter
James J. Carroll*
Holly A. Harrison
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for the Amicus Curiae
*Counsel of Record

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